

**SUMMARY OF COMMENTS RECEIVED IN CONJUNCTION WITH THE HEARING OF  
AUGUST 6, 1999 ON PROPOSED REGULATIONS 19041 AND 19044, STAFF  
RESPONSES AND RECOMMENDATIONS**

**Both Proposed Regulations, General**

**Comment:** In general, we find the [proposed] regulations tilt the administrative appeals process in favor of the FTB. (*Cal-Tax*, p. 1; *Dave Doerr*, Transcript, pp. 78-79)

**Response:** It is assumed that this is a summary paragraph that details the substance of specific concerns which are responded to as they are brought up with respect to specific provisions of the regulation.

**Recommendation:** Dealt with in the discussion of individual concerns.

**Comment:** In general, we believe that the proposed regulations are well thought out and well meaning. This is a difficult area and we can see by the proposed text of the regulations that the department was attempting to bring "rough justice" to a number of diverse situations. (*Ernst & Young LLP*, p. 1)

**Response:** None required.

**Recommendation:** Not applicable.

**Claim for Refund**

**Comment:** The proposed regulations do not deal with the conversion of a protest to a claim for refund. This fact is not discussed in either of the proposed regulations. It is an important issue and should be addressed if the proposed regulations are promulgated. (*Pillsbury, Madison & Sutro*, Comment 2)

**Response:** Paying a proposed assessment while a protest is pending converts the protest, by operation of Section 19335 Rev. & Tax. Code, into a claim for refund. It would generally be more appropriate to address issues raised by this conversion in regulations adopted pursuant to that statute. An addition of a cross-reference to that statute might add clarity. It does not appear that this comment has any application to proposed Regulation 19044.

**Recommendation:** Add a cross-reference to Section 19335 to proposed Regulation 19041 with a statement of the consequences that can arise.

**Comment:** Section 19041 is too vague regarding claims for refund. What happens if a claim for refund is filed with the protest? Is the taxpayer or the

taxpayer's representative required to file a separate claim for refund, and if so, doesn't that merely create an additional administrative burden on the taxpayer? (*Arthur Andersen LLP*, p. 1, and *Arthur Andersen*, Transcript, pp. 60-61 and 66)

**Response:** Proposed Regulation 19041 deals with the filing of a protest. Claims for refund are dealt with in separate sections of the Revenue and Taxation Code, Section 19301, et seq. Claims for refund have their own separate set of procedures and time frames. A taxpayer can file a single document that constitutes both a protest and a claim for refund. Generally the department will not treat a document as a claim if filed as a protest to a Notice of Proposed Assessment even if the grounds raised would result in a refund of tax. Taxpayers should identify the document as both a protest and a claim for refund.

**Recommendation:** Add language that if an overpayment might arise, there is a need to identify the protest as a claim for refund, and that any such filing would be subject to the statute of limitations applicable to claims for refund.

## **Necessity**

**Comment:** No necessity for the particular contents of the regulations has been established by the Office of Administrative Law ruling regarding the classification of an FTB form as an underground regulation. (*Richard E.V. Harris*, p. 1)

**Response:** The ruling by the Office of Administrative Law that then-existing forms constituted "underground regulations" does establish a need for regulations to the extent it is appropriate to have any rules, procedures or practices that the OAL ruling found to be improper. The fact that other rules or procedures may also be promulgated of a nature similar to those found to be improper in the OAL ruling establishes that those rules or procedures must also be adopted by regulation or they will be subject to attack as "underground regulations."

**Recommendation:** The OAL ruling does establish the need for a regulation regardless of the content of the rules to be adopted. The statement of reasons will, nonetheless, contain an expanded statement of necessity.

**Comment:** Portions of the proposed regulation are not necessary, and do not conform to the statutes. (*Arthur Andersen*, p. 1)

**Response:** Specific comments are provided with respect to individual subsections and are responded to directly and not responded to here.

**Recommendation:** Changes are recommended as appropriate.

## Clarity

**Comment:** Grammatical and sentence order concerns. (*Spidell Publishing, Inc.*)

**Response:** A number of suggestions were made to reorder the words within various sentences with a goal of greater clarity or to substitute a word such as "shall" for "will." Those suggestions that the department has determined are nonsubstantive in nature have generally been accepted.

**Recommendation:** Make recommended changes.

**Comment:** The proposed regulations are ambiguous and/or inaccurate in numerous places. The intent of several of the provisions is also unclear. In some instances, the language of the proposed regulations is inconsistent with established practice and longstanding commentary on the required procedures for filing a protest. (*Richard E.V. Harris*, p. 1)

**Response:** Individual comments and suggestions are dealt with under the appropriate portion of the regulation. To the extent staff believes greater clarity can be achieved, suggestions are adopted or changes are made.

**Recommendation:** Suggestions are dealt with on an individual basis.

**Comment:** The proposed regulations 19041 and 19044 are not "readily understandable by the persons 'directly affected.'" We have identified areas of confusion and made modification recommendations below. (*Arthur Andersen*, p. 1)

**Response:** Specific comments are provided with respect to individual subsections and are responded to directly and not responded to here.

**Recommendation:** Dealt with within the specific comments.

**Comment:** The proposed Regulations are convoluted and will make the process complex. They are too technical. (*Spidell Publishing, Inc.; Eric Coffill, Morrison & Foerster*, Transcript, pp. 95-97)

**Response:** The necessity for the regulations was created by a challenge to a form that the Franchise Tax Board had issued that described the nature of the Protest process as an "underground regulation." This challenge was sustained by the Office of Administrative Law. It was therefore determined necessary to propose regulations to provide information and guidance to taxpayers with respect to the Protest process. The complexity which may have arisen in this process primarily results from efforts by the department to create certainty and to spell out specific standards and rules upon which taxpayers can rely and to

provide defined exceptions. It may be appropriate to add general material in the introductory subsection that provides a description of the process with cross-references to specific sections within the regulation.

**Recommendation:** Add additional descriptive language in the first subsection of the regulation to provide an overview and philosophy of the regulations with cross references to specific items in the text of the regulations.

**Comment:** There is a lack of clarity in the provisions dealing with timing which are particularly significant in that they deal with substantive rights and have potentially constitutional significance. (*Richard E. V. Harris*, Attachment A, Item No. 34)

**Response:** There is no specific indication as to where the lack of clarity exists. Staff believes further detail was provided in the extended commentary and has responded to those comments as they apply to specific provisions of the proposed regulations.

**Recommendation:** No change is required as a result of the specific comment, though it is believed specific suggestions have been responded to throughout the proposed regulations.

## Consistency

**Comment:** There are no procedures to assure consistent interpretation. Some process for consistent interpretation would be useful. (*Arthur Andersen*, Transcript, p. 67)

**Response:** Protests are handled either as undocketed or docketed. Undocketed protests are handled by the audit staff, and docketed protests are handled by the legal staff. In either circumstance, protests are processed through a single entry point. When assigned, they are handled by a relatively small number of individuals under the supervision of a more limited number of managers. The small number of individuals involved in the process leads to consistency of application. It is not the intent of the regulation to establish a process that will itself give rise to disputes as to whether the process and standards have been followed.

**Recommendation:** No change is required.

## Authority

**Comment:** The authority for the proposed changes is lacking or uncertain. (*Richard E. V. Harris*, p. 1)

**Response:** The proposed regulations are the first regulations to be adopted pursuant to these statutes and they do not constitute changes to existing regulations. To the extent the proposed regulations represent changes from existing practices, they are based on the underlying statutes which direct some of the results. They are also the product of the regulatory process itself and the adoption of specific rules by regulation, an ability which has always existed even though not exercised. The regulations are also a product of the direction of the three-member Franchise Tax Board to accelerate the process of resolving protests.

**Recommendation:** Sufficient authority exists for the regulations. Additional support will be added to the statement of reasons.

## Informality

**Comment:** The protest proceedings have traditionally been informal in nature and do not lend themselves to a series of strict rules and requirements. Both regulations should be carefully reviewed with this concern in mind. (*Pillsbury, Madison & Sutro*, Comment 1)

**Response:** The intent in drafting the proposed regulations was not to increase the formality of the process. Formality, however, is, to a certain extent, the product of publishing rules. To the extent rules and requirements are proposed, this was done so as to provide a set of guaranteed rights for taxpayers. In virtually every setting, the Franchise Tax Board is given the discretion to waive requirements, and the proposed regulations provide that the rules and the exercise of discretion be liberally applied to the benefit of the taxpayer. Additional language will be added to the introductory subsection of the proposed regulation to emphasize the informality of the process and to indicate that the purpose of stating rules is to establish the rights of the taxpayers during the protest process.

**Recommendation:** Add additional language to the initial subsection of the proposed regulation emphasizing the informality of the process and the establishment of rules to provide taxpayer safeguards.

## FTB Notice 99-1

**Comment:** The regulations should set forth their relationship to FTB Notice 99-1, which sets forth time limits for staff consideration of protests. The timing set forth in the Notice and the deferrals allowed are important procedural rights. FTB employees take timing matters very seriously. The deferral procedure is an important topic that should be covered by the regulations. If the FTB is going to operate under timing constraints they should appear in the regulations. (*Michael Herbert, Arthur Andersen LLP*, August 10, 1999; *Arthur Andersen*, Transcript, pp. 60 and 74-77)

**Response:** FTB Notice 99-1 advises the public of guidelines that have been provided to the FTB staff in processing and resolving protests. These guidelines are not absolute rules and were not intended to be rules of uniform application to be applied to taxpayers. The proposed regulations are silent as to time limits because there was no intention to mandate them upon taxpayers or to mandate them for every case. Each protest is unique, and a single rule with respect to time frames does not fit all protests.

The deferral procedures are internal to the department and a taxpayer has no specific right to rely upon them or be governed by them. Sufficient notice is provided to the public of the standards and guidelines for department staff through the publication of FTB Notice 99-1.

**Recommendation:** No change is required.

**Comment:** Is the 33-month timeline from FTB Notice 99-1 applicable? How does the transfer of a case to the Settlement Bureau affect the timing? (*Arthur Andersen LLP*, p. 1, and *Arthur Andersen*, Transcript, p. 60)

**Response:** FTB Notice 99-1 advises the public that internal policies have been established that provide for the processing of most protests within 33 months. The guidelines are not reflected in the proposed regulations because they are not directed to taxpayers and are not intended to establish hard and fast rules for processing cases. The transfer of a case to the Settlement Bureau would toll the 33-month period under FTB Notice 99-1.

**Recommendation:** No change is required.

## **Adverse Economic Impact**

**Comment:** It is difficult to understand the protest and hearing process based upon a reading of the proposed regulations. RRU staff had to call the Board staff on numerous occasions to discuss the process and rules in the proposed action. RRU staff also spoke with numerous individuals and groups representing corporations, small businesses, and individual taxpayers. The industry representatives confirmed RRU's finding that the [proposed] regulation text is hard to understand and frequently unclear. These representatives are familiar with Board practices. If they felt the proposed text was confusing and unclear, RRU believes small businesses and individual taxpayers, who are much less familiar with the rules of the Board, will have an even more difficult time complying with the proposed regulations. Current practices confirm that the proposed regulations are hard to understand. These clarity issues may have an adverse economic impact on corporations, small businesses, and individual taxpayers. (*California Trade and Commerce Agency*, Regulation Review Unit, p. 1)

**Response:** Specific comments with respect to clarity are addressed individually and should make the process easier to understand. In addition, staff recommends that a generalized description of the protest be added to the first subsection of the regulation to increase clarity.

**Recommendation:** Make recommended changes for clarity and add general description language to the first subsection.

**Comment:** Any unpaid tax owed to the state, which is the subject of the protest, will continue to accrue interest during the pendency of a protest. This adds to the other adverse impacts being incurred by the taxpayer. (*California Trade and Commerce Agency*, Regulation Review Unit, p. 2, Adverse Economic Impacts)

**Response:** The assessment of interest is mandated by statute. There is no provision for the tolling of interest during the pendency of a protest. The impact arises from the statutes, not the regulation. The taxpayer has the option of paying the assessment while continuing to contest it to mitigate this impact. The proposed regulation has no economic impact with respect to the accrual of interest.

**Recommendation:** No change is permitted by regulation.

**Comment:** Small businesses and individuals may not have tax accountants or attorneys "on staff" to handle their protests. The complexity and lack of clarity in the proposed regulations make it likely small businesses and individuals will need to hire a professional to not only explain the process to them, but also to handle the preparation and presentation of the protest. (*California Trade and Commerce Agency*, Regulation Review Unit, p. 2, Adverse Economic Impacts)

**Response:** The protest process is intended to be informal but is also dictated by the statutes. Complexity has been added by efforts to provide specific guaranteed rights to taxpayers and notice of the consequences of actions or inactions.

**Recommendation:** No changes other than those otherwise recommended.

## Exercise of Discretion

**Comment:** There are a number of instances in the proposed regulations where the FTB is granted unfettered discretion to relax the [proposed] regulation's strict requirements; however, only a few of those are accompanied by an explicit statement that the FTB will exercise its discretion liberally in the taxpayer's favor. In our view, the [proposed] regulation should contain a blanket statement to the effect that the standard of liberal exercise of discretion in the taxpayer's favor applies to every instance in which the FTB may exercise its discretion. Without

such assurance, the standardless grant of discretion would place FTB decisions beyond the reach of any challenge by taxpayers, which not only is inappropriate for governmental decisions but may also violate taxpayers' due process rights. (*Morrison & Foerster LLP*, pg. 4, Footnote 3)

**Response:** Staff recognizes the efficiencies of resolving matters at the lowest level possible and inserted the liberal discretion standard where it thought it was appropriate. Making this a standard of general application in addition to including it in specific areas is appropriate.

**Recommendation:** Place a statement in the introduction to the proposed regulations indicating that discretion shall be liberally exercised to allow for resolution of issues at the lowest administrative level possible.

**Comment:** There are a number of instances in both regulations that speak to the discretion of the Franchise Tax Board. Consideration should be given to including an objective standard for the exercise of that discretion. (*Ernst & Young*, p. 1; *Richard Harris*, Transcript, pp. 33-37; *Cal-Tax*, p. 1)

**Response:** In most circumstances discretion is provided to the department after a specific rule has been stated and specific exceptions noted. A further definition of when discretion will be exercised places another layer of rules that may lead to disputes centered on the process, rather than the underlying issue to which the protest is addressed.

**Recommendation:** No change is required.

## Due Process

**Comment:** The regulation limits the introduction of a new ground after the protest is filed. However, it is well established that the FTB refuses to produce a copy of a taxpayer's audit file until after the protest is filed. Hence, this has the effect of requiring the taxpayer to establish his complete case before he is permitted to determine the extent of the FTB's position. This violates a taxpayer's Constitutional right to due process, violates California law, and goes against common sense.

Further, it is well established that FTB audit and protest proceedings are exempted from the California Administrative Act because they are merely "investigations" and that a protest officer can continue the investigation by requesting new information during the protest. To require a taxpayer to complete his case in the middle of the FTB's "investigation" also violates a taxpayer's Constitutional right to due process, violates California law, and goes against common sense.

Finally, it is believed that the State Board of Equalization and the California courts will permit a citizen to provide new grounds and arguments, particularly in



view of the above-mentioned violations of a taxpayer's right to due process. Hence, it is unreasonable to deprive the protest officer of new arguments and related new evidence that the protest officer and the FTB will have to deal with as the administrative and legal proceedings progress. (*Riordan & McKinzie*, pp. 1-2)

**Response:** The limitation in the regulation on the introduction of new grounds derives from the statute which provides a specific time period for the filing of a protest and the requirement that the Protest set forth the grounds. It is not a product of the proposed regulation. The proposed regulation reflects the statute and is consistent with the judicial interpretation of other similar sections, in particular the section authorizing a suit for refund. It should also be noted that the proposed regulation provides specific exceptions to the rule limiting the protest to those grounds raised in the original filing and in addition provides the department with discretion to accept additional grounds.

The Franchise Tax Board does not produce an audit file until an audit has been completed. In general, an audit is completed at the time the taxpayer receives a Notice of Proposed Assessment and the audit file can be requested and will be produced in response to such a request. There is no requirement that a protest be filed in order to receive a copy of the audit file once the audit is completed. The timing of the production of a taxpayer's audit file is not relevant to the filing of a protest. The Notice of Proposed Assessment sets forth the basis of the assessment. It provides a sufficient basis for a protest to be filed. The audit file can be requested after the audit is completed and reviewed prior to the protest being filed and certainly prior to action being taken on the protest. It should also be kept in mind that audits normally include written requests for information and a review of the taxpayer's books and records. Obviously the fact that a particular area is being examined does not mean that an adjustment will be proposed. It is not until a Notice of Proposed Assessment is issued that the right to Protest ripens.

The protest process does not violate a taxpayer's constitutional right to due process, it does not violate California law (a fact that the commentator appears to acknowledge), and does not go against common sense. "An adjudicative proceeding before an administrative officer or board is sufficient if basic due process requirements are met, including notice and an opportunity for hearing." *Witkin*, Cal. Proc. 4<sup>th</sup> 1057, Administrative Proceedings Section 3. The statute involving notices of proposed assessments and the filing of a protest provides both notice, a time period for response and the opportunity for a hearing. "The particular form of the hearing and notice that is constitutionally required in adjudicative proceedings varies with the circumstances. Due process 'is flexible and calls for such procedural protections as the particular situation demands. (*Smith v. Organization of Foster Families for Equality & Reform* (1977) 431 U.S. 816.) When a statutorily prescribed procedure exceeds minimum due process standards, the statute must be followed." *Witkin*, Cal. Proc. 4<sup>th</sup> 1057, Administrative Proceedings, Section 3.

The role of the Protest hearing officer is to determine the correct amount of the tax to be assessed. In order to make this determination, it is frequently

necessary to make additional inquiries to confirm claims which the taxpayer has asserted. In tax proceedings there is a presumption that the proposed assessment is correct. This presumption arises because it is the only the taxpayer which possesses or has control over the records necessary to sustain their position. Because of this, it is appropriate for the hearing officer to request additional information in order to be certain that a correct determination of the protest is made.

The commentator is correct that taxpayers may raise new or additional grounds either in an appeal to the State Board of Equalization, in a claim for refund, or in a suit for refund. These additional remedies further establish that the taxpayer is not being denied any due process rights. The department agrees that differences are best resolved at the lowest level but the process remains time sensitive. An extension of the commentator's argument would result in proceedings that would never be closed.

**Recommendation:** A reference can be added to the effect that the Administrative Procedure Act is not applicable to the protest hearing process.

**Comment:** The regulations cast the protest as an objective administrative proceeding by an objective protest officer but this is misleading and inequitable. It is misleading and inequitable for the regulations do not explain to taxpayers that the protest is exempted from the Administrative Procedure Act [Administrative Adjudication's Act, §§ 11400 Government Code] and is a biased investigation, not an objective administrative proceeding. It is also misleading and inequitable for the regulations not to explain to taxpayers that the protest is an opportunity for the protest officer to further learn a taxpayer's case to use against the taxpayer in an appeal to the State Board of Equalization. (*Riordan & McKinzie*, p. 1)

**Response:** The taxpayer has the burden of establishing that the proposed assessments are in error. It is the taxpayer that is in possession of the books and records upon which the correctness of the assessments or of the protest can be determined. The taxpayer has the duty of establishing the correctness of its position. The hearing officer does function as an objective adjudicator, but one that is constrained by the rules regarding the burden of proof. It is not clear what would be added by a statement to the effect that protest proceedings are exempted from the Administrative Adjudicative Act, but such a statement could be added. Staff does not believe that the protest process is a biased investigation. Statistics show that the protest process is not a rubber stamp of audit findings.

The proposed regulation does indicate that documents submitted during the course of a protest can be used in subsequent proceedings. It also indicates that there is no transcript prepared during protest hearings and no oaths administered. Oral statements made during the course of the protest are typically not used in subsequent proceedings except to the extent various procedural defenses might be claimed on the part of the department.

**Recommendation:** A reference can be added to the effect that the Administrative Procedure Act is not applicable to the protest hearing process.

## Alternatives

**Comment:** The statute regarding the adoption of regulations requires the department to consider alternatives. In order to consider alternatives you have to determine what is trying to be accomplished. It appears that something other than responding to the OAL determination of an underground regulation or implementing FTB Notice 99-1 is attempting to be accomplished. The staff should be looking at other models such as the Board of Equalization's hearing officer process where the hearing officers are walled-off from the rest of the department or the FTB's own settlement process. (*Eric Coffill, Morrison & Foerster*, Transcript, pp. 91-95)

**Response:** The Administrative Procedure Act requires the consideration of other alternatives. Staff has interpreted this to mean the consideration of alternatives to the regulation, not necessarily alternatives to the rules promulgated in the regulation. The existence of the OAL ruling classifying forms prepared by the department as "underground regulations" is evidence by itself of the consideration, and use, of another alternative, which was found to be improper.

Another possible meaning of the consideration of alternatives refers to the substance of the proposed regulations, rather than the promulgation of a regulation as opposed to the adoption of forms etc. The department did not consider alternatives to its current protest process and hearing process such as would be contemplated by reference to the Board of Equalization's hearing process or the department's own Administrative Settlement process. Staff does not believe that the consideration of alternative processes to the current methods is required by the Administrative Procedure Act. Whether such alternatives should be considered is a decision to be made by the three-member Franchise Tax Board and the department's management.

**Recommendation:** No change is required.

## Request for Symposium

**Comment:** The proposed regulations should have been made the subject of a preliminary symposium. (*Cal-Tax*, p. 1; *Dave Doerr*, Transcript, p. 78; *Eric Coffill, Morrison & Foerster*, Transcript, p. 95)

**Response:** It was not anticipated that the proposed regulations would draw the interest that they have. The symposium process that the department has engaged in a number of times is not a requirement of the Administrative Procedure Act. This issue was discussed several times at open Franchise Tax

Board meetings, and no objections were voiced by the public in having the proposed regulations proceed directly into the regulatory process. The Franchise Tax Board, at its meeting of September 16, 1999, directed staff to hold a symposium on the proposed regulations.

**Recommendation:** The proposed regulations should proceed through the administrative process since they are already in it. A symposium will be held, and a summary of the issues raised and the discussion will be included in the administrative record of the regulations.

### **Request for additional Hearing**

**Comment:** Given the deficiencies of the proposed regulations another notice hearing seems to be required. The questions, points, and comments and suggestions set forth in the commentary are illustrative. (*Richard E. V. Harris*, p. 1)

**Response:** Staff does not believe the regulations, as proposed, or the notice were deficient. This does not mean, however, that substantive changes are inappropriate. The principal purpose of providing notice and holding hearings is to allow for the presentation and consideration of alternatives. If substantive changes are proposed and recommended, the Administrative Procedure Act requires that another notice be prepared and issued and another hearing be held. The issues raised in the current set of comments can be addressed in the subsequent notice without rendering invalid the prior notice and hearing. The questions, points, comments and suggestions will be responded to individually under the appropriate headings.

**Recommendation:** It is contemplated that a symposium, a hearing before staff, and a hearing before the Franchise Tax Board will be held which will satisfy the request for a second hearing.

**Comment:** The changes proposed at the hearing [on the basis of the Spidell comments] are substantive in nature and not appropriate for only a 15-day notice. (*Dave Doerr*, Transcript, pp. 90-91)

**Response:** Staff does not believe the changes proposed as the result of the comments provided by Spidell Publications were substantive. Other changes may be proposed which are substantive, which would require another noticed 45-day hearing. This will cure any defect in notice that may exist with respect to the changes made as a result of the Spidell Publication comments.

**Recommendation:** Another hearing will be held in any event, so no further action is required.

## **Request for Hearing by the Three-Member Franchise Tax Board**

**Comment:** It is requested that the final regulation be sent to the Board for approval pursuant to Government Code Section 15702. (*Cal-Tax*, p. 1; *Dave Doerr*, Transcript, p. 78 and 91; l. 14-16, *Morrison & Foerster LLP*, p. 2)

**Response:** It was always contemplated that the proposed regulations would be submitted to the three-member Board. Government Code section 15702 allows any person to make such a request.

**Recommendation:** The request is acknowledged. The proposed regulations should be scheduled for a hearing by the three-member Board. This hearing will take place after the symposium and a second 45-day noticed hearing with staff.

## **Scheduling of Hearing on Proposed Regulations**

**Comment:** The hearing was noticed for the same period of time the American Bar Association meetings are being held in Atlanta, Georgia, and on the very day of the meeting of the Section of Taxation's State and Local Taxes Committee. The proposed regulation addresses matters of legal procedure. Given the Board's authorization last March for your scheduling this hearing, the delay in scheduling the hearing until this particular day is unfortunate. Why was this date selected? Was the staff aware of the conflict? (*Richard E. V. Harris*, p. 1; *Richard Harris*, Transcript, p. 49-50)

**Response:** The date was selected without any consideration of the ABA meeting. It was happenstance that the two dates were congruent. Arrangements were made to allow telephonic participation from Atlanta for the individual who expressed concerns. Telephonic participation is seldom totally satisfactory, but provision was made for concerns to be expressed. Seldom can hearings be scheduled to every individual's convenience. The individual's comments are part of the record. At least one more hearing will be held which will provide for the opportunity for additional comment.

**Recommendation:** No change is required. The scheduling of a second hearing can serve to address the concerns expressed.

## **Proposed Regulation 19041**

**(a)**

**Comment:** The proposed regulation does not commit the FTB to act in a reasonable manner or in a fair and impartial manner in the administration and review of a taxpayer's protest. The regulation should do so. An express commitment to act in a reasonable, fair and impartial manner is appropriate. In addition to being an expressed reminder to all members of the FTB staff, the expression of commitment would inform the public of the standards and

principles that the Board itself has adopted for the administration of the tax laws of the State of California. Protests are delicate points in the taxpayer-FTB relationship. An express commitment in the regulation to act in a reasonable, fair and impartial manner would be good policy. Given the perennial questions regarding California's business climate and the adverse impact of tax agency conduct, such an express commitment is needed.

There is no protection in the proposed regulation against these procedures being used to bootstrap a proposed assessment that lacks a reasonable, factual basis and a reasonable legal basis, where auditors, in effect, would – these procedures would be used indirectly to extend the statute of limitations and to extend the audit. (*Richard Harris*, Transcript, pp. 33-41)

It is suggested that that this subsection be amended to include two sentences at the end which state:

The department shall act in a reasonable, fair and impartial manner in the administration, review and determination of a taxpayer's protest. Any department discretion shall be exercised in a reasonable manner.

(*Richard E.V. Harris*, p. 2, Nos. 1-5; *Richard Harris*, Transcript, pp. 33-41; *Arthur Andersen*, Transcript p. 58)

**Response:** The department's mission statement already contains statements that the laws are to be administered in a fair and impartial manner and to be construed in a manner intended to effectuate their intent. Many of these standards are highly subjective in nature. Staff does not believe that a requirement that it administer the statutes in a fair and impartial manner is necessary because that requirement already exists. Staff is concerned that including such statements in the regulation will only provide a source of disputes as to whether the protest process has been administered pursuant to the regulation. The purpose of the proposed regulations is to provide guidance to taxpayers as to the rules applicable to the protest process. The purpose of a protest is to determine whether the taxpayer's tax has been correctly determined. It is not the intention of the staff to create a structure that will give rise to controversies as to whether proper procedures have been followed. It is the intent of staff that discretion be liberally exercised to allow for the full resolution of a dispute with a taxpayer as to the amount of tax that is owed at the lowest possible level of the process.

**Recommendation:** A statement should be added to the proposed regulation as to the responsibility of staff in resolving protests. Another statement should be added indicating that staff will be liberal in its exercise of discretion so that disputes may be resolved at the lowest possible level.

**Comment:** In a number of specific areas throughout the regulation, comments were made suggesting that broad statements regarding the nature and purpose

of the protest proceedings should be added in order to aid in the interpretation and construction of the proposed regulation. It appears that these statements of a general nature are appropriately included in the introductory subsection of the proposed regulation. (*Staff*)

**Response:** Not applicable.

**Recommendation:** Add language to the introductory subsection to describe the nature and purpose of the protest proceeding to aid in the interpretation, construction and application of the proposed regulation.

**(b)**

**Comment:** The date placed on the Notice of Proposed Assessment is not an adequate basis for presuming, as a matter of law, the actual date of mailing. Section 19041 of the Rev & Tax Code provides for 60 days "after the mailing of each notice." As drafted, the regulation places an impermissible limitation on taxpayers in contravention of the statute. (*Cal-Tax*, p. 2, Section 19041(b), Time for Filing Protest; *Dave Doerr*, Transcript, pp. 80-81)

**Response:** Taxpayers have a need to know how the Franchise Tax Board will determine the date of mailing. The proposed regulation indicates that the department will treat the date of the Notice of Proposed Assessment as the date of mailing. This is consistent with the department's normal practices with regard to mailing. The taxpayer can rebut the department's assumption. The staff recommends that the language of presumption be removed.

**Recommendation:** Remove the language of presumption.

**Comment:** Section 19041 was amended in 1999 to require the Franchise Tax Board to include on the Notice of Proposed Assessment a specification of the date determined by the Franchise Tax Board to be the last date for filing a protest. (*Staff*)

**Response:** Not applicable.

**Recommendation:** The proposed regulation should be amended to reflect the changes in the statute.

**(b)(1)**

**Comment:** The use of the terms "filed" and "mailed" appears to be inconsistent. (*Spidell Publishing, Inc.*, p. 1 of Attachment)

**Response:** The statute itself uses both terms which, in part, gives rise to a requirement to use both terms. In addition, the department intended to

specifically establish that the method of filing a protest is by mail. By requiring a single method of filing, the department is attempting to ensure that all protests will be recognized when received and properly recorded and processed. The staff recommends that this should be changed and changes should be made in the proposed regulation.

**Recommendation:** No change is required here.

**Comment:** The beginning of the period for filing a protest should contain language to account for Saturdays, Sundays and holidays. (*Spidell Publishing, Inc.*, p.1 Attachment 19041)

**Response:** In the context of a 60-day period for filing a protest, whether the beginning date is a Saturday, Sunday or holiday is not of great significance. It does have significance for the end of the period. The last day of the period establishes whether a protest is timely. In addition, it is highly unusual for a mailing to be made from a business office on a Saturday, Sunday or holiday.

**Recommendation:** No change is required.

**Comment:** The second and third sentences of subsection (b)(1) are not clear and are potentially misleading. The phrase "is presumed to be" should be **may be presumed by the taxpayer** to be." (*Richard E. V. Harris*, Attachment A, Item Nos. 19 and 20)

**Response:** The normal business practice of the department is to mail a Notice of Proposed Assessment on or before the date on the notice. The department would never assert that the date of mailing is earlier than that which appears on the notice. Taxpayers are entitled to be informed of the department's normal business practice and the position the department will take as to the date of mailing of the Notice of Proposed Assessment. The words of presumption can be removed.

**Recommendation:** Remove the language of presumption.

**Comment:** The second and third sentences of subsection (b)(1) are not clear and are potentially misleading. Any suggestion of a limitation in the last sentence, "may be rebutted by the postmark on the envelope," should be eliminated. The taxpayer should not be limited to the postmark on the envelope as the only evidence to rebut the presumption that the date of mailing is the date reflected on the Notice of Proposed Assessment. (*Richard E. V. Harris*, Attachment A, Item Nos. 19 and 20, Supplement A, Item No. 33)

**Response:** Staff recommends that the language of presumption be removed. Nonetheless, taxpayers need to be advised of the need to establish that a filing of a protest was timely. The last sentence sets forth a means of establishing this



fact. It was not intended to be a limitation on the means of establishing this, but only a suggestion as to one means. Indicating that a postmark is an example, and not a limitation, is appropriate.

**Recommendation:** Add language to the proposed regulation to clearly indicate that the means of establishing the date of filing is not limited to a postmark.

**Comment:** Administratively, various dates have been placed on the FTB's Notices of Proposed Assessment. The date on the Notice of Proposed Assessment is **not** a record date of the date of mailing. This is acknowledged by the Franchise Tax Board. The date on the notice is neither the date of the preparation of the notice nor necessarily the actual date of mailing of the notice. Because the FTB is subject to statutory jurisdictional time limits (i.e., statutes of limitations) for issuing notices, the FTB's regulatory statement regarding the presumption should, at most, be a presumption that the taxpayer can rely upon. The FTB may not by regulation create a presumption applicable to its own satisfaction of a statutory jurisdictional deadline for complying with the statute of limitations. The Franchise Tax Board should be required to prove the date of mailing of a Notice of Proposed Assessment. (*Richard E. V. Harris*, Supplement A, Items 21-32, and 35; *Richard Harris*, Transcript, pp. 20-26)

**Response:** The business practice of the department is to mail the Notice of Proposed Assessment on or before the date on the Notice. The department will take the position that such date is the date of mailing. It is not necessary to state this as a presumption, but it is appropriate to advise taxpayers of the position that the department will take. The department will prove the date of mailing by reference to the date on the Notice of Proposed Assessment and its normal business practices, as established by its mail room personnel.

**Recommendation:** The language should be changed to eliminate the presumption.

**Comment:** To the extent the date on the notice is viewed as controlling, it lacks authority. (*Richard E. V. Harris*, Supplement A, Item 35)

**Response:** The controlling date is the mailing of the notice. That is provided by statute. The regulation repeats the statute and states the position the department will take with respect to the date of mailing. Authority arises both from the statute and the authority of the Franchise Tax Board to adopt regulations.

**Recommendation:** Add language specifically indicating that the taxpayer may establish a different date of mailing.

**(b)(1) & (2)**

**Comment:** Subsection (1) of proposed Regulation 19041 discusses a protest being "timely" and subsection (2) relates to a protest being "timely filed." The use of the different terminology lacks clarity. These sections appear to create different standards for filing a protest whether in person or via the mail without apparent reason. Perhaps the solution is to provide that the "statute of limitations" runs 60 days after the later of the date appearing on the NPA or the actual mailing of the protest as evidenced by the postmark on the envelope or other competent evidence. (*Cal-Tax*, p. 2, Section 19041(b), Time for Filing Protest; *Dave Doerr*, Transcript, p. 80)

**Response:** The distinction noted exists and to the extent the different wording gives rise to a lack of clarity it should be changed. No different standards are created for filing a protest whether in person or by mail. The proposed regulation provides that filing is to be by mail only, see subsection (c) of the proposed regulation. Staff recommends that this be changed so that filings can occur by other means. If both types of filing were permitted, there would probably be different standards. Filing in person requires actual delivery on or before the statutory date. Filing by mailing only requires that the protest be mailed by the specified date. It does not require that it be received by the Franchise Tax Board on or before the 60<sup>th</sup> day.

The suggested phrasing does not provide clarity. The end of the 60-day period is established by reference to the mailing of the Notice of Proposed Assessment. The date of the mailing of the Protest does not establish the ending date of the period. It establishes the date of the mailing of the Protest and whether or not it was done within the 60-day period. The suggestion to use the later of two dates is appropriate if reference is made to the mailing date of the Notice of Proposed Assessment.

**Recommendation:** Changes should be made to reflect that filings can be other than by mail, and that the due date is established by the later date of either the Notice of Proposed Assessment or the date of mailing of such Notice.

**Comment:** Having both a beginning and ending date is too complicated. (*Spidell Publishing, Inc.*, p.1, Attachment 19041)

**Response:** The statute provides for a 60-day period. In order to know when the 60-day period expires, it is necessary to define both the day on which it begins and the day on which it ends. By defining both days, confusion is minimized.

For example, if the beginning day were not defined, an argument could be made that the period begins on the date the taxpayer receives the mail, rather than the date of the notice or the date of postmark. It would be difficult for the department to determine the beginning date, because it has no knowledge of the date the taxpayer received a document. The only date it can verify is the date that

appears on the Notice of Proposed Assessment or the date of the postmark on the envelope in which the Notice of Proposed Assessment was mailed.

With respect to the ending date, a rule needs to be established as to how it is determined and how Saturdays, Sundays and holidays are to be dealt with in determining whether the filing was timely.

**Recommendation:** No change is required.

**(b)(2)**

**Comment:** Is the determination of whether a protest is timely filed made by reference to the mailing or the date of mailing of the protest? (*Spidell Publishing, Inc.*, p.1, Attachment 19041)

**Response:** The date of mailing of the protest establishes the date on which the protest is filed. The protest period is measured from the date of mailing of the Notice of Proposed Assessment. The statute uses the word "mailing" in reference to the Notice of Proposed Assessment and "filing" with respect to the protest. The word "mailing" satisfies the requirement of the statute but the date of mailing provides greater specificity as to when it occurs and how it will be determined.

**Recommendation:** No change is required.

**(b)(3)**

**Comment:** Subsection (3) limits the type of evidence that may be used to establish a timely-filed protest. The statutory authorization does not place a limitation on establishing the date of mailing. If the department does not retain the envelope, is it incumbent upon the taxpayer to affirmatively establish that the statute of limitations has been met in every case in which a protest has been filed? For example, if a taxpayer files a protest 30 days after the mailing but has no record of that fact, is their protest barred even if the FTB does not contest the date of filing the protest? (*Cal-Tax*, p. 2, Section 19041(b), Time for Filing Protest; *Dave Doerr*, Transcript, pp. 81-83)

**Response:** It was not the intent of the department to limit the means of proving the date of mailing. The language about the department not retaining the envelope was intended to notify taxpayers of a need to have evidence if the question of timely filing should arise. If the department does not contest the date of filing a protest, the protest will not be barred.

**Recommendation:** Add additional means of establishing the date of filing.

**Comment:** The statement that the department is not required to retain the envelope in which the protest is mailed is inconsistent with the ability of the taxpayer to rebut the date on the Notice as the date of mailing through a postmark on an envelope. (*Richard E.V. Harris*, Item No. 36)

**Response:** The department does not regularly retain envelopes in which protests are mailed. In some circumstances it may do so. This is most likely to occur when a protest has not been timely received. The language in the regulation is intended to put taxpayers on notice that the department does not regularly retain envelopes, so they can take alternative steps to establish proof of mailing if they have reason to be concerned. Additional language can be added to the proposed regulation to provide for alternative means of proving the date of mailing.

**Recommendation:** Language should be added to the proposed regulation indicating that other means can be used to establish the date of mailing.

**Comment:** Because the FTB is not required to retain the envelope that the protest is mailed in, the taxpayer is, practically speaking, required to send the protest by certified mail. The FTB should be required to retain the envelope. (*Arthur Andersen LLP*, p. 2, and *Arthur Andersen*, Transcript, pp. 61-62)

**Response:** The language in the regulation was intended to put taxpayers on notice that the FTB does not normally retain envelopes in its processing of mail. A taxpayer who believes there may be a problem as to whether a protest is mailed timely should take whatever steps it believes are necessary to establish the date of filing.

**Recommendation:** No change required.

(c)

**Comment:** A valid protest should not be limited in manner of delivery to "mailings." There is no rational basis to suggest such a limitation. The statute does not authorize such a restriction. Taxpayers should continue to be permitted to file in person at any branch office of the FTB as well as receiving proof of filing if filed in person. (*Cal-Tax*, p. 2, Section 19041(c), Manner of Filing; *Dave Doerr*, Transcript, p. 82)

**Comment:** The proposed regulation appears to create a requirement that a protest be mailed in order to be filed. Filing by mail should be permissive, not required. To require that filing be accomplished by mail is a change of practice and there is no authority for this change. If this change is intended, the notice with respect to the regulation should explicitly so state. It does not do so. Physical delivery to an FTB office should be sufficient. May a protest be filed by hand delivery to an FTB office within the 60-day time period? There is no file-by-mailing limitation in the statutes. Filing by mail is recognized as a

substitute for physical filing but it is not a requirement. Tax "guidebooks" indicate that protests can be filed at branch offices. Any appropriate means of physical delivery should be sufficient. (*Richard E.V. Harris*, Item No 37-48; Richard Harris Transcript pp. 14-16, 19-20)

**Comment:** The [proposed] regulation should be changed to refer first to filing at any FTB office in the State of California, or at any of the several official FTB Field Offices, and then to the permissive filing by mail, which is deemed to be equivalent to filing at an FTB office on the date of the mailing. (*Richard E.V. Harris*, Attachment A, Item No. 51)

**Response:** There is a rational reason for the requirement of filing by mail. This is to ensure proper identification and handling of protests. Allowing protests to be filed at any branch office of the department, or at any mailing address, significantly increases the likelihood that the protest will not be recognized as such and that time periods may expire resulting in the assessment of the additional taxes proposed. The department does not keep statistics on the manner in which filings are made. Nonetheless, staff is confident that the vast majority of protests are filed by mail.

Under other statutes regarding filings with the department, requirements are imposed for filings in specific locations and not at any branch office. However, the protest statute does differ from the suit for refund statute, which designates with greater specificity who is to be served. The department currently accepts protest filings at branch offices. Staff believes that the Board has the ability, under its regulatory powers, to define how a filing is to be accomplished. Furthermore, the department does not currently have in place any procedures for providing a taxpayer with a proof of filing for a protest that is delivered to a branch office. Nevertheless, staff recommends that the proposed regulation be amended to allow filings at any office of the department but that filing by mail remains the preferred method.

Staff does not recommend that filings be allowed by FAX or E-mail at this time because no numbers or procedures have been established for such filings. Staff will continue to try and accommodate filings of this nature, but filings sent to random addresses at the department, or to specific addresses which have not been designated as places of filings for protests, gives rise to the risk that such filings will be mishandled.

Tax "guidebooks," to the extent they are not published by the department, do not create any authority as to the method of filing.

**Recommendation:** The proposed regulation should be modified to allow for filing at branch offices, but indicate a preference for filing by mail.

**Comment:** The requirement that protests be filed by mail and that the date of mailing must be established by the taxpayer is burdensome in that it may require a taxpayer to send the protest by certified mail or some other special delivery

service in order to ensure the protest was received on time or was received at all. The Board should consider giving taxpayers the option of hand delivering and/or faxing their protests to the Board. With additional options, taxpayers will be able to use the least burdensome and least costly way to ensure the timely filing of tax protests. RRU contacted the Board of Equalization to understand how they handle the filing of tax protests. The Board of Equalization permits taxpayers to hand-deliver and fax protests, and RRU feels this alternative should be considered by the Franchise Tax Board. (*California Trade and Commerce Agency*, Regulation Review Unit, p. 3, Less Burdensome Alternatives)

**Response:** The requirement for mailing to a specific address was included in the proposed regulation in an effort to ensure that protests were properly handled. Hand delivery to any office of the department and submission by FAX increases the likelihood that a protest will not be recognized and properly recorded and may give rise to disputes over whether it was filed at all or timely filed. The use of regular mail is generally the least expensive alternative for filing. Provision should be made to allow for hand delivery but with a preference for mail delivery. FAX delivery appears to be impractical unless delivery is limited to a specific phone number.

**Recommendation:** Modify the proposed regulation with respect to hand delivery, with preferred mailing delivery, and investigate the possibility of establishing a FAX number, and the possibility of E-filing.

**Comment:** There should be no limitation on the address to which a protest can be mailed. Addresses reflected on the Notice of Proposed Assessment have been changed over the course of several years. In addition, the address is set forth on the back of the form and frequently representatives receive a copy of only the front of the form. It appears that this requirement is likely to induce errors in the filing of protests. To the extent this was intended it should be reflected in the notice of the proposed regulation. (*Richard E.V. Harris*, Items 49-50; *Richard Harris*, Transcript, pp. 17-18; *Arthur Andersen*, Transcript, p. 62-63)

**Response:** A limitation is necessary. Approximately fifteen million returns are filed with the Franchise Tax Board every year. Correspondence that is sent to a return filing address is frequently mishandled and treated as a return regardless of how it is denominated. Even with respect to returns, separate addresses are used for different types. A limitation on the address where a protest is mailed is necessary and appropriate.

**Recommendation:** No change is required.

**Comment:** To make this address more accessible, it should be posted on the Internet, if it is not already. (*Arthur Andersen LLP*, p. 2; *Arthur Andersen*, Transcript, p. 62)

**Response:** The best source for an address is on the Notice of Proposed Assessment. It will be current as to the particular Notice of Proposed Assessment. Posting the address on the Internet is an alternative that will be explored. As with all Internet postings there is the problem of maintaining the currency of the information.

**Recommendation:** No change is required.

(d)

**Comment:** The proposed regulation should be revised so that taxpayers are not overburdened with detailed mandatory requirements for preserving their right to file a protest. Taxpayers vary in their ability to comply with detailed mandatory requirements for written protests and no necessity has been demonstrated for the imposition of mandatory requirements. Some of the requirements are also confusing. (*Richard E.V. Harris*, Item Nos. 54 and 62)

**Response:** The information that is required is necessary to correctly identify the taxpayer and their complaint. Each of these items can be subsequently perfected either by the taxpayer or at the request of the department. A document signed by John Smith stating "I protest the additional tax proposed to be assessed" for example, would not have sufficient detail for the department to identify who was protesting or what they were protesting.

**Recommendation:** No change is required.

**Comment:** The proposed regulation 19041 is silent regarding the extent to which a taxpayer may supplement a protest to add facts and legal authorities. A statement that a taxpayer may supplement its protest with facts and authorities at any time during the protest process should be added. (*Morrison & Foerster, E.*, p. 8)

**Response:** Proposed regulation 19041 speaks to the submission of facts and legal authorities in several places.

Subsection (d)(5) contains a requirement to specify grounds and set forth facts and reasons. This is a mandatory requirement. Subsection (d)(6) allows for the submission of legal authorities. This is not made a requirement because the statute does not require it and most protests are filed by unrepresented individuals who may not have access to authorities or be familiar with how to find them.

Subsection (e) provides, in several instances, for the submission of new, additional or alternative grounds. Subsection (f) allows for the perfection if grounds have not been stated. Subsection (f)(3)(D) specifically provides the right to provide additional information and legal authorities in specific circumstances.

Subsection (g) provides the department with the right to request additional information.

In general, information that allows for correct resolution of the protest is always welcome. Obviously there is need to complete a protest at some time. Inserting a statement that information and authorities can be submitted at any time gives rise to the ability to delay the completion of consideration of a protest indefinitely. Staff determined that it was more flexible to not include a statement of limitation with respect to this issue.

**Recommendation:** No change is required.

**(d)(1)**

**Comment:** This section should be clarified by stating that no special form is required. (*Arthur Andersen LLP*, p. 2; *Arthur Andersen*, Transcript, p. 63)

**Response:** If this would add clarity, it can be added.

**Recommendation:** Add a sentence stating that no special form is required.

**Comment:** Whether a written protest is dated is irrelevant. The only relevant date is that of filing the protest, which may or may not have any correlation to the date of the writing of the protest. Nothing in the authorizing statute requires the protest to be dated. (*Cal-Tax*, p. 3, Section 19041(d) Form; *Dave Doerr*, Transcript, p. 82)

**Comment:** There is no requirement of dating in the statute therefore the words "must be dated" should be stricken, or at least revised to "should be dated." There is no indication what date should be included. The relevant date is the date of filing a protest, not the date of drafting or the date of signing. The provision is also ambiguous regarding the "date" of what that "must" go on the protest. There is no necessity to make it mandatory to place a date on the protest, particularly when "date" of what is left ambiguous. If a date is desired, the regulations should only state that a date should be included. The FTB cannot even produce such records. (*Richard E. V. Harris*, Attachment A, Item Nos. 55-61)

**Response:** The fact that the filing of a protest is a time-sensitive action establishes the need to have a basis to determine the date on which an action occurred. The date on a written protest is one item that can be looked at to determine whether a protest is timely. It obviously would not be controlling if there were contrary evidence, but it would normally be assumed to be the date of filing. It is currently the practice of the department to treat the date on a protest as the date of filing unless there is evidence to the contrary. Clarification should be provided as to the lack of a requirement of a date, the reasons for a date and what that date should relate to for purposes of the protest.



**Recommendation:** Modify the statement to indicate that though the date is not required to be included, there may be a need to establish the date of filing, and the date on the protest provides some evidence of that date.

**Comment:** A request was made to add to the record that portion of the taxpayer bill of rights hearings where evidence of a letter from a taxpayer that began "I am writing to protest" where the Franchise Tax Board did not docket the protest. The assertion being it wasn't a real protest. (*Richard Harris*, Transcript, pp. 31-33)

**Response:** The item should be incorporated into the record. It is not clear that such an assertion would qualify as a proper protest in that it does not set forth a ground upon which the protest is based.

**Recommendation:** N/A

(d)(2)

**Comment:** The list of requirements in (A) through (H) is unduly burdensome and should not be mandatory. (*Richard E. V. Harris*, Item No. 57)

**Comment:** The word "shall" must be changed to "should." Making this a mandatory requirement creates the potential for all kinds of defects that could be potentially manipulated by the staff to say that a protest was invalid. This is an unfair requirement. It appears that the FTB is trying to create conceivable weapons to try to use to defeat taxpayer protests. (*Richard E. V. Harris*, Item No. 56; *Richard Harris*, Transcript, pp. 26-27)

**Response:** The information required is necessary to properly identify the taxpayer and the protest. The requirements are the name of the taxpayer(s), the identifying number(s), the current address, the amount being protested, the year(s), the identifying numbers on the Notice of Proposed Assessment, the date on the Notice of Proposed Assessment, and a statement if the taxpayer is contesting the date of mailing. These items do not appear to be burdensome. All but the last one may be included on the Notice of Proposed Assessment.

All of these items can be cured by additional or supplemental filings that are permitted by the regulation. These requirements cannot be manipulated by the staff to say that a protest is invalid. Even if a protest is not perfected, action will be taken on it through a notice of action, thereby preserving a taxpayer's right to appeal to the Board of Equalization.

**Recommendation:** No change is required.

**Comment:** The list of contents in a protest should include "grounds." (*Morrison & Forester*, E. p. 8)

**Response:** The requirement of grounds was set off separately because it is of a more substantive nature than the listing of items required for identification of the item being protested. It could be included in (d)(2) but staff was of the opinion that it was accorded greater significance by being stated separately.

**Recommendation:** No change is required.

**Comment:** The items in subsections (c)(2)((A)-(H) [sic the commentator apparently meant (d)(2)(A)-(H)] are repeated in subsections (4) to (6). (*Cal-Tax*, p. 3, Section 19041(d) Form; *Dave Doerr*, Transcript, p. 83)

**Response:** This does not appear to be correct. Repetition by itself is not per se impermissible.

**Recommendation:** No change is required.

#### **(d)(2)(H)**

**Comment:** This requirement should be eliminated. The date on the Notice of Proposed Assessment is neither a record of the date of preparation or mailing and is therefore irrelevant. The taxpayer does not have access to the FTB records of the date of mailing and therefore cannot be in a position to contest the date of mailing. (*Richard E. V. Harris*, Items Nos. 58-59; *Richard Harris*, Transcript, pp. 27-32)

**Response:** This requirement should only arise if the taxpayer is attempting to explain the reason why a protest is filed more than 60 days after the date on the Notice of Proposed Assessment. This requirement serves an important purpose in putting the department on notice as to a possible reason why the taxpayer's protest is filed beyond the 60-day period for filing a protest. The date on the Notice of Proposed Assessment does reflect the date of mailing in the normal course of the department's business practices. This statement is included in the proposed regulation to advise the taxpayer that it is possible to contest the date of mailing. If this is an issue that the taxpayer wishes to raise, it is important to have it set forth immediately so the matter can be resolved at the outset of the protest. If the taxpayer is asserting that the Notice of Proposed Assessment was mailed subsequent to the date on the Notice as a reason for the filing of a protest beyond the 60-day limitation of the statute, it is necessary to resolve this question to determine if there is a valid protest.

A taxpayer does not need access to the department's records to contest the date of mailing. First, the envelope in which the Notice of Proposed Assessment was mailed should be postmarked. Second, the date of receipt of the Notice of Proposed Assessment by the taxpayer may suggest that in the normal course of mail delivery the Notice of Proposed Assessment should have been received at an earlier date.

It is necessary to start with some date as the evidence of the date of mailing. It is appropriate to tell the taxpayer what the Franchise Tax Board will assert the date is. The taxpayer is free to rebut.

**Recommendation:** The language of the subsection should be changed to reflect that this information should be included if the taxpayer is filing a protest more than 60 days after the date on the Notice of Proposed Assessment.

#### (d)(2)-(6)

**Comment:** Not all of the requirements contained in subsections (2) through (6) are contained in the statute. The statutory requirements are that it be timely filed, that it be in writing, that it identify the specific NPA, and the grounds upon which it is based. *Suggesting* that such additional information be provided would be acceptable, but allowing the FTB to deny protest based on the lack of these requirements is inconsistent with the statutory authorization and substantially limits taxpayers' rights to challenge an NPA. (*Cal-Tax*, p. 3, Section 19041(d), Form; *Dave Doerr*, Transcript, p. 83)

**Response:** The requirements set forth in this subsection allow for the identification of the NPA involved, the identity of the taxpayer, the amounts at issue and where contact is to be made with the taxpayer. The requirement that a request for oral hearing be made in the Protest arises from Section 19044. The requirement of signature is for purposes of authenticating the protest. The request for legal authorities is not mandatory. Not all of this information may be specifically stated as a requirement in the statute, but each item serves a valid purpose and is properly included in the proposed regulation. The taxpayer must be given the opportunity to correct any defects, see subsection (f).

**Recommendation:** No change is required.

#### (d)(3)

**Comment:** Subsection (3) requires a request for an oral hearing be expressly stated and included in the original protest. The authorizing statute (Section 19044 Cal Rev. & Tax. Code) is not a limitation on taxpayers but an affirmative requirement that the FTB grant an oral hearing if requested. What is the justification for the limitation? As a practical matter, the taxpayer may not have grounds to believe that a hearing is necessary until after the protest is originally filed. (*Cal-Tax*, p. 3, Section 19041(d), Form; *Dave Doerr*, Transcript, p. 83)

**Response:** There is a requirement for an oral hearing only if it is requested in the protest. See Section 19044. The proposed regulation reflects that requirement. The regulations provide for an oral hearing even when it is not requested in the original protest. Over ninety-five percent of the protests are resolved without a hearing.

In the course of processing the protest, either the taxpayer or the department may suggest that an oral hearing might be appropriate.

**Recommendation:** No change is required.

**Comment:** The regulation should provide for an oral hearing and allow a taxpayer to elect out of an oral hearing. We believe that the overwhelming majority of cases involve oral hearings. Rather than create a trap that the ill informed or underrepresented taxpayer can fall into, it seems to us that in the interest of fair administration, assuming an oral hearing would be better. (*Ernst & Young LLP*, p. 3)

**Comment:** There is no statutory authority requiring a taxpayer to request an oral hearing in its protest or to forever waive the right. Because there is no statutory authority for such a restriction, this provision appears to exceed the FTB's authority and to be invalid. If the regulation is to address the right to oral hearings at all, it should presume that every taxpayer is entitled to and will receive an oral hearing unless the taxpayer expressly waives it. It is unlikely to give rise to an increase in hearings and would prevent unwary taxpayers from being barred from exercising their right. (*Morrison & Foerster, D.*, p. 7)

**Response:** The request for an oral hearing is dealt with more fully in proposed regulation 19044. The commentators reference the statute which states " . . . and, if the taxpayer has so requested in his or her protest, shall grant the taxpayer . . . an oral hearing." The statute unambiguously states that a hearing will be granted, if requested, and unambiguously states that the request will be in the protest. The proposed regulations do nothing more than follow the requirements of the statute. The department can allow hearings in other circumstances, but it is not required to do so by the statute.

The proposed regulations do allow for the granting of a request for a hearing in other circumstances and provides specific circumstances where such a request will be allowed. It further indicates the department will be liberal in granting a request. See proposed regulation 19044(b)(2) generally and subsection (A) specifically.

One of the commentators asserted that the overwhelming majority of the cases involve an oral hearing. This is incorrect. An oral hearing is held in fewer than five percent of the cases that are protested.

**Recommendation:** No change is required.

**Comment:** Limitations on oral hearings are not justified. The statute does not limit oral hearings. It only mandates them if requested at the time of a protest is filed. Communication between the FTB and the taxpayer will increase the chance that the amount of tax is correctly calculated. (*Arthur Andersen LLP*, p. 3; *Arthur Andersen*, Transcript, pp. 63-64)

**Response:** The proposed regulation reflects Section 19044 of the Revenue and Taxation Code which mandates a hearing only if a request is made in the protest. The proposed regulation is an effort to inform taxpayers of their rights. The proposed regulation indicates that a hearing can be granted even if not requested in the original protest. The department agrees that communication with a taxpayer concerning the protest will increase the chance that the tax is correctly calculated.

**Recommendation:** No change is required.

**Comment:** The request for an oral hearing should be part of (d)(2) Contents. (*Spidell Publishing, Inc.*, p.2, Attachment 19041)

**Response:** Subsection (d)(2) sets forth the necessary elements of a protest. A request for an oral hearing is not a necessary requirement to file a protest. It is a right that is given, and if the taxpayer wishes to exercise it, the request must be in the original protest. It is properly addressed in a separate section.

**Recommendation:** No change is required.

#### (d)(4)

**Comment:** The requirement of signature is not a requirement to a valid protest. It is proper to suggest that a protest be signed it is not proper to require it. (*Cal-Tax*, p. 3, Section 19041(d), Form; *Dave Doerr*, Transcript, p. 83)

**Response:** There has to be some method of authenticating the fact that a protest has been filed by a proper person. The requirement of signature, while not set forth in the statute, provides the means for this authentication. The filing of a protest keeps the proposed assessment open for the year, and interest continues to accrue on open assessments. It would not be fair to taxpayers to allow just anyone to file a protest on their behalf so that interest would continue to run on a proposed assessment if the taxpayer did not wish to file a protest.

**Recommendation:** No change is required.

**Comment:** The requirement of a signature should be included in (d)(1) as part of the writing. (*Spidell Publishing, Inc.*, p.1, Attachment 19041)

**Response:** The requirement of signature is a separate item from the fact the protest must be in writing. It is properly set forth as a separate item.

**Recommendation:** No change is required.

**(d)(5)**

**Comment:** The statute has a requirement that the grounds upon which the protest is based be set forth. There is no requirement that the facts involved be reiterated nor that the taxpayer is in any way bound or limited to arguments submitted in the original protest. (*Cal-Tax*, p. 3, Section 19041(d), Form; *Dave Doerr*, Transcript, pp. 85-86)

**Response:** The statute contains a requirement of "specifying . . . the grounds upon which it is based." Grounds may include facts and/or reasons and/or legal precedents. The statute sets forth a requirement that the grounds be set forth in the protest. These requirements, on their face, are not limitations. The department can act upon a protest based upon only what is filed or subsequently submitted.

Under a strict construction of the statute, which requires that the protest must be filed within 60 days and specify the grounds upon which it is based, there is a basis to argue that limitations apply as to the arguments that can be advanced in support of the protest. The proposed regulations provide exceptions to this rule, and it is the intention of the department that taxpayers be allowed to pursue all of their grounds during the protest process consistent with a timely resolution of the protest.

**Recommendation:** No change is required.

**Comment:** Providing that the grounds and reasons for a protest be specified is theoretically proper. However, it is quite often the case that it is difficult to draft a protest with much specificity due to the fact that the Franchise Tax Board is not required to make a precise summary of the proposed adjustments in the Notice of Proposed Assessment. The process would be improved tremendously if the Franchise Tax Board provided a precise discussion of the proposed adjustments with the Notice of Proposed Assessment. This would allow a more thoughtful analysis of the issues and a more focused filing of a protest. For example, taxpayers should not have to make a formal request for a copy of the audit narrative. It should be provided as a matter of course. (*Pillsbury, Madison & Sutro*, Comment 3)

**Response:** Section 19034 Revenue & Taxation Code states that each notice [of deficiency assessment] "shall set forth the reasons for the proposed deficiency assessment and the computation thereof." If the requirements of this statute are not met the taxpayer can raise this in their protest. Raising this question as an issue should guarantee the taxpayer an opportunity to obtain clarity with respect to the grounds of the proposed deficiency assessment. In addition, the taxpayer is provided with a right to perfect either on their own initiative or after a request is made by the Franchise Tax Board for additional information. This should provide adequate assurances that issues can be fully developed.

Also, a taxpayer is not limited in the grounds upon which a protest can be based. It is certainly relevant to the taxpayer to know the basis of the Franchise Tax Board's proposed deficiency assessment, but this does not limit the taxpayer's ability to raise additional grounds.

The Franchise Tax Board issues over 300,000 notices of proposed deficiency assessment each year. Approximately four percent of those notices are protested. A request for an audit narrative is made in a very small percentage of the cases that are protested. Supplying an audit narrative with every notice of proposed deficiency assessment would be extremely costly and inefficient and is not required by any statute.

**Recommendation:** No change is required.

**Comment:** How much detail is required? What if the facts change? (*Arthur Andersen LLP*, p. 3; *Arthur Andersen*, Transcript, p. 65-66)

**Response:** No standard of detail was contained in the proposed regulation to avoid any suggestion that a protest might be held to be invalid because it did not contain enough detail. Protests are filed by individual taxpayers and by highly trained professionals in the field of taxation. It would be inappropriate to establish requirements that could not be met by everyone.

The facts should not change since the Notice of Proposed Assessment is dealing with a period in the past. Knowledge of the facts may change, and a taxpayer is entitled to submit additional facts as they become known until the protest is acted upon. The protest is not a taxpayer's last opportunity to present facts; it still has a right of appeal and the right to file a claim for refund after the payment of tax.

**Recommendation:** No change is required.

**Comment:** This section proposes an unreasonable burden on the taxpayer or the taxpayer's representative by requiring that all potential grounds for the protest, all relevant facts and all areas of protest be collected and organized in just 60 days. Taxpayers should be free to supplement the grounds for the protest with additional arguments. The goal of the FTB should be to arrive at the correct assessment--not to win simply because an additional argument was not outlined in the protest. For instance, at the point in time of the protest, a relevant [issue] may not have even been decided. (*Arthur Andersen LLP*, pp. 3-4)

**Response:** The statute, not the regulation, imposes the requirement that protests be filed within 60 days and that the grounds be specified. It is not the intent of the proposed regulation to set a trap for the unwary. Other provisions of the regulation provide for the addition of new or additional grounds, see subsections (e)(4), (f) and (g). The goal of the FTB is to resolve disputes efficiently and fairly at the lowest level possible by arriving at the correct result.

Subsequently decided cases can always be taken into account in resolving a protest if they are applicable.

**Recommendation:** No change is required.

**Comment:** The FTB places no such restriction on itself, feeling free to make new arguments at protest. The playing field should be level. If the FTB does not believe that a taxpayer(s) should be able to supplement their grounds for a protest, then the department should similarly be restricted to only the grounds raised by the department at audit. (*Arthur Andersen LLP*, p. 4; *Arthur Andersen*, Transcript, p. 66)

**Response:** A taxpayer is not limited to the grounds it may raise in a protest. The raising of new grounds may give rise to consideration of new issues in response to those grounds. The FTB should not be limited in its ability to assert those new grounds which address issues not considered in the audit.

The taxpayer has the opportunity to raise new grounds in the protest and has additional opportunities through an appeal to the State Board of Equalization or the filing of a claim for refund to pursue additional grounds. The FTB does not have any additional opportunities except as a defense to a claim for refund. Such a defense only allows it to avoid paying a refund, not assert additional tax.

**Recommendation:** No change is required.

**Comment:** Also, the FTB should set forth their grounds for assessments in a very precise manner in the Notice of Proposed Assessment. This would provide a starting point from which the taxpayer or the taxpayer's representative may begin their analysis/argument. (*Arthur Andersen LLP*, p. 4)

**Response:** Section 19034 of the Revenue and Taxation Code requires that a Notice of Proposed Deficiency "shall set forth the reasons for the proposed deficiency assessment and the computation thereof." This is the section that controls what needs to be in a Notice of Proposed Deficiency. A taxpayer can object to the Notice on the grounds that it is inadequate. It should be noted that a taxpayer is not limited in its grounds to the issues upon which the Notice of Proposed Deficiency was issued.

**Recommendation:** No change required.

#### **(d)(5) & (6)**

**Comment:** The grounds and reasons and legal authorities should be included in subsection (d)(2) as part of the contents of the protest. (*Spidell Publishing, Inc.*, p.1, Attachment 19041)



**Response:** The primary purpose of (d)(2) is to provide notice to the department with sufficient specificity that a Notice of Proposed Assessment does not go final and become billable. Statements as to grounds and legal authorities are necessary for notice purposes and are therefore listed separately as elements of the written protest.

**Recommendation:** No change is required.

**(d)(6)**

**Comment:** The requirement of setting forth the legal authorities is not a requirement to a valid protest. It is proper to suggest that a protest include these items, it is not proper to require it. (*Cal-Tax*, p. 3; *Dave Doerr*, Transcript, p. 84)

**Response:** The proposed regulation does not require a statement of legal grounds. It indicates the protest "should" contain a statement.

**Recommendation:** No change is required.

**Comment:** A statement of the legal authorities should be required. Substitute the word "must" for "should" (*Spidell Publishing, Inc.*, p.2, Attachment 19041)

**Response:** It is preferable that a protest contain a statement of legal authorities. However, most of the protests that are filed with the department are by individual taxpayers and are completed without the advice of a tax professional. Requiring that legal authorities be included would discourage or prevent the filing of protests by many individuals. The use of the word "should" is appropriate.

**Recommendation:** No change is required.

**(e)**

**Comment:** There is no statutory authority allowing the FTB to limit the grounds that a taxpayer can raise after it files its original protest. In restricting the rights of taxpayers in a manner that is not provided for in the California statutes, the proposed regulation appears to exceed the scope of the statutes on which it is based and, therefore, is invalid.

In a footnote it is asserted that there is no authority supporting the conclusion that the grounds may not be supplemented or amended in subsequent submissions. (*Morrison & Foerster, I.A., "First"*)

**Response:** The statute provides a limited period of time for filing and a requirement that grounds be specified. What is the effect of the language

requiring a specification of grounds, if it is not to limit the grounds to be considered in the protest?

As stated in a footnote to the commentary, "A claim for refund or a protest may be amended so long as the statute of limitations remains open." The 60-day period is a statute of limitations for the filing of a protest. A protest can be amended prior to the expiration of the 60-day period, but once it has expired, no new grounds need to be considered. Arguably the only basis on which the proposed regulation exceeds the scope of the statute is that it allows the consideration of new issues beyond the 60-day period.

It is true that the period for filing a protest may expire prior to the running of the normal statute of limitations, and therefore a taxpayer can raise new grounds regarding the return that was filed. This would be done through the filing of a claim for refund. The proposed regulations do not affect the right of a taxpayer to file a claim for refund. In most circumstances, such a "claim" or new ground would be raised prior to action on a protest, and it would be appropriate to consider it in conjunction with the protest.

**Recommendation:** No change is required.

**Comment:** Limiting the grounds that a taxpayer may raise in a protest is contrary to the purpose and spirit of protests. In light of the fact that a taxpayer may raise any ground whatsoever in both a later appeal to the State Board of Equalization and a subsequent claim for refund, it is evident that the protest process was not intended to be an exhaustion-type procedure. To the contrary, in order for the entire appeals process, from the notice of deficiency to Superior Court action, to be as efficient as possible, the development of all possible issues should be encouraged at the earliest stage of these appeals, *i.e.* the protest stage. In this way, during the protest process the FTB and the taxpayer will be able to sift through the full panoply of issues, leaving only those truly meritorious issues about which there is a legitimate dispute, which can then be resolved by the State Board of Equalization or a court. Unfortunately, the taxpayer and /or its representative frequently do not know all of the grounds for the protest at the time that the protest is filed. Sixty days may not be enough time to determine all of the grounds that may be raised, especially if the taxpayer engages a new representative. In addition, the law commonly changes during the pendency of a protest, either due to retroactive issuance of regulations, a State Board of Equalization or court decision, or for other reasons. Taxpayers will be penalized and the entire appeals process will suffer if taxpayers are restricted in raising grounds discovered after filing the original protest. (*Morrison & Foerster, I.A., "Second"*)

**Response:** Staff agrees with the comments regarding the spirit and philosophy of the protest process and the goal of resolving the issues at the lowest level possible. It is for these very reasons that the proposed regulation allows for the introduction of new grounds or issues both for specified periods of time and at the discretion of the department consistent with timely and efficient tax

administration. This does not, however, mean that new grounds can be raised forever. Time limits were attached by the legislature to the filing of a protest for the purpose of cutting off disputes at some point. If 60 days is an insufficient time period, then requests for a different period need to be addressed to the legislature. The proposed regulation can not overrule the legislative directive in this regard.

**Recommendation:** No change is required.

**Comment:** Limiting the grounds for a protest will be counter-productive because a taxpayer may raise new issues in a State Board of Equalization appeal or a taxpayer may pay the disputed tax and raise new issues in a claim for refund. It would be more efficient to allow new grounds to be raised and resolved in the protest process even if not identified in the original protest, rather than inducing another level of administrative appeals. (*Morrison & Foerster*, I.A., "Third"; *Deloitte & Touche*, Transcript, pp. 51-52)

**Response:** The proposed regulation does allow for the introduction of new grounds. A balance needs to be struck between the ability to introduce new grounds and the achieving of finality as to disputes. Both appeals to the State Board of Equalization, from denial of a protest and a claim for refund, have their own time constraints and issues-limitation rules. The arguments made with respect to the protest process could also be made with respect to each of those processes, leading to a virtually endless dispute process.

If a claim for refund is filed, the department has the ability to defend against that claim on any ground. It does not have to be a ground that it has audited or previously raised with the taxpayer.

**Recommendation:** No change is required.

**(e)(1)**

**Comment:** The second sentence inappropriately limits taxpayers as to the grounds upon which they can file a protest. Often there are reasons to raise issues in the protest which involve situations where no adjustment was made by the auditor or where an affirmative adjustment is now being raised by a taxpayer. The taxpayer should not be barred from raising these issues in the protest. (*Pillsbury, Madison & Sutro*, Comment 4)

**Response:** Staff agrees that a taxpayer can file a protest on any ground and that the two sentences are inconsistent. The word "not" was inappropriately left out of the second sentence.

**Recommendation:** The word "not" should be added to the second sentence.

**Comment:** The regulation puts no limit on the FTB from raising additional or alternative grounds at protest. If the taxpayer is limited in raising grounds, the FTB should be prevented from doing the same. Proposed subsection (e)(2) should be modified to state that the FTB is limited to the grounds for the adjustment stated in the audit. (*Deloitte & Touche*)

**Response:** The proposed regulation deals with the filing of protests. It does not address the grounds for a Notice of Proposed Deficiency Assessment. It would not be proper to place limits on the FTB in the proposed regulation. In addition, taxpayers are not limited in protesting a Notice of Proposed Assessment to the grounds for the adjustment. They only have to state the grounds. They do not have to relate them to the proposed adjustment. Because of the statute of limitations, the FTB is limited in time as to when it can make a proposed assessment. If an NPA has been issued and the statute runs, the amount of tax which can be assessed is limited to the NPA amount. The taxpayer can raise new grounds in the protest; if the protest is denied, it can file an appeal with the State Board of Equalization; and if the taxpayer loses, there it can pay the tax and file a suit or claim for refund. The FTB can defend a claim for refund on any ground including grounds not raised in the Notice of Proposed Deficiency. There is no unfairness.

**Recommendation:** No change is required.

**Comment:** This subsection limits a protest to the grounds stated in the original protest filed with the FTB unless the department exercises its discretion to allow introduction of new or additional grounds protesting the adjustments in the Notices of Proposed Assessment (NPA). Under current procedures, taxpayers are able to introduce new grounds at any time during the protest period. Subsection (e)(4)(B) states that a request will be accepted if the request is submitted at least 60 days before the hearing, otherwise acceptance is discretionary.

The State Board of Equalization will allow additional or alternative grounds to be put in an appeal of a protest from the FTB at any time prior to the appeal hearing. It makes no sense for the FTB to limit the introduction of additional or alternative grounds at protest when they can be raised at appeal. It is suggested that either subsections (e)(2), (3), and (4) be eliminated, or, alternatively, have the taxpayer sign a statement acknowledging responsibility for delay. (*Deloitte & Touche*)

**Response:** The statute sets forth a time period for filing a protest and requires a statement of grounds. The proposed regulation allows for the submission of additional grounds in recognition of the fact that the State Board of Equalization's practices are generally as described. The department does not intend to apply this rule to prevent consideration of items at the lowest administrative level possible but it still needs to write a rule of limitation consistent with the statute and to provide notice to taxpayers. Having a taxpayer acknowledge responsibility for delay may provide comfort to an individual employee or manager but is irrelevant in terms of the command of the statute.

**Recommendation:** No change is required.

**Comment:** What happens if a Claim for Refund is made with the protest?  
(*Arthur Andersen LLP*, p. 4; *Arthur Andersen*, Transcript, p. 61)

**Response:** A claim for refund can be filed in conjunction with a protest. This fact should be noted if it is accomplished through a single filing. There can be different time periods, rights and duties that apply to the different types of filings. The department does not automatically treat a protest that ultimately results in a reduction of tax in excess of that proposed to be assessed as a claim for refund. Circumstances can arise where a protest is timely but a claim for refund is not except to the extent the taxpayer makes an additional payment.

**Recommendation:** Language should be added to the proposed regulation to make clear the need to file a claim for refund if it is possible that allowing the protest might result in a reduction of tax in excess of that proposed to be assessed.

**(e)(2)**

**Comment:** Taxpayers should be allowed to introduce new, additional, or alternative grounds even after an original protest has been filed any time prior to the issuance of a determination. In conjunction with the over reaching of the requirements for form, these provisions work to substantially limit taxpayer's ability to protest NPAs. The FTB has literally months to prepare a case supporting the NPA, yet the NPA does not provide an exhaustive or authoritative justification for the proposed assessment. Here, the FTB suggests taxpayers be given a mere 60 days, not just to decide whether to protest, but to also set forth all of the grounds and legal authority supporting such a protest through the entire dispute. (*Cal-Tax*, p. 3, Section 19041(e)(2), Grounds for Filing a Protest, also p. 1, 2<sup>nd</sup> ¶; *Dave Doerr*, Transcript, p. 84)

**Response:** It is the statute, not the regulation, that imposes the initial 60-day period. Whether this is an appropriate time period is a legislative determination. The requirement of setting forth the grounds is also a requirement of the statute. It is a requirement that is part and parcel of the 60-day period. The proposed regulations provide opportunities to extend these periods, but such opportunities should not be endless.

The proposed regulation provides specific circumstances in which new, additional or alternative grounds can be raised after the original filing of a protest. It allows the department discretion, to be liberally exercised, to allow new, additional or alternative grounds to be raised in other circumstances. The proposed regulation also allows a protest to be supplemented. The statute itself reflects a legislative determination that there are time constraints on the taxpayer in making decisions regarding proposed assessments. This process needs to

come to an end and taxpayers need to be advised as to when it will come to an end. That is what the proposed regulation does.

It may take the department some time to make its audit determinations. These determinations are not made in a vacuum. In most circumstances involving lengthy audits, a taxpayer is aware of the issues that are being examined. It is seldom that proposed adjustments are a matter of complete surprise. The typical taxpayer is not caught unaware.

**Recommendation:** No change is required.

**Comment:** It is often in the best interest of fair administration to allow new grounds to be raised. If the ultimate resolution of the issue based on the new grounds will result in a reduction of the amount due (or a complete cancellation of the amount due), it seems in the best interest of all to allow the grounds to be considered. (*Ernst & Young LLP*, pp. 3-4)

**Response:** The department agrees that the purpose of the protest process is to determine the correct amount of tax. In order to make this determination, all issues should be considered. However, the legislature has established a statutory framework, including statutes of limitations, to control the administration of the tax system. Both the department and taxpayers must comply with this framework. As part of this framework the statute provides that protests are to be filed within 60 days and the grounds are to be specified. The proposed regulation provides opportunities for new or additional grounds to be considered during the processing of the protest consistent with completing the protest process.

**Recommendation:** No change is required.

**Comment:** Why should the department not permit the introduction of new grounds when the taxpayer is in the assessment mode and, therefore, could always pay up, file a claim for refund and then raise a new ground? If the taxpayer is limited to the grounds stated in the protest, the department should be so limited to the grounds raised in the Notice of Additional Tax Proposed to be Assessed. (*Ernst & Young LLP*, pp. 2 and 4)

**Response:** Cases must be brought to an end. The protest statute states that the protest must specify the grounds upon which it is based. Allowing the introduction of new grounds after a protest is filed is recognition of a desire to resolve cases while they are in the assessment mode. But delay cannot be allowed to extend forever. The protest statute speaks to the rights and duties of the taxpayer. It does not contain any limitation upon the department.

**Recommendation:** No change is required.

**Comment:** What purpose is served by limiting relevant issues from being discussed? (*Ernst & Young LLP*, p. 2)

**Response:** The periods for filing a protest, an appeal, or a claim for refund are all limited. There must be an end to disagreement over an assessment. The department agrees that generally cases are best resolved at the lowest level possible. This has been the department's practice and adoption of this regulation is not expected to change this practice. But the department is also aware of cases that have been dragged out for years, apparently for the purpose of avoiding payment of the tax. Certainly there are cases where the taxpayers earnestly believe they do not owe the tax and will not agree with an assessment. However, perpetuating a case at the protest level by seeking to find a new fact or new way to make an argument results in a delay in the ultimate resolution of the case by a third party. There must be a way to bring cases to an end at all levels.

**Recommendation:** No change is required.

**Comment:** New grounds should be allowed at any time during the protest proceeding. This should not be discretionary with the department. In addition, the department should not be allowed to raise new grounds. (*Spidell Publishing, Inc.; Hochman, Salkin, Rettig, Toscher & Perez P.C.*)

**Response:** The protest statute, similar to the claim for refund statute, is time limited and states that the grounds must be specified. Allowing the raising of new grounds at any time other than the original filing is not consistent with the statute but appears to be an appropriate exercise of discretion to allow under the statute given the fact that the taxpayer can otherwise raise the grounds. Nevertheless, at some point there must be an end. The statute requires an end, and the regulation attempts to implement the statute in a manner which allows taxpayers flexibility.

**Recommendation:** No change is required.

**Comment:** An attempt to accelerate the protest process may be an admirable objective, but it should not be achieved at the expense of taxpayers and of the protest process as a whole. Limiting grounds will trap unwary taxpayers and will compromise the objective of resolving issues at the lowest level possible so that only meritorious and genuinely disputed issues remain if the matter proceeds. Especially because the authority of the department to restrict taxpayer rights to raise grounds is seriously in question, it is recommended that this subsection be stricken. There are far better ways to ensure that protests are resolved more quickly, including especially requiring shorter times for taxpayers and the FTB to respond to correspondence. (*Morrison & Foerster*, "at bottom," p. 5)

**Response:** The proposed regulation reflects the language of the statute. The ability to raise new grounds, and providing commitments as to when those grounds may be raised, is an effort to allow for early resolution of disputed

matters. The intent of the proposed regulation is not to set traps but to provide safeguards.

**Recommendation:** No change is required.

**Comment:** The issue of raising new grounds really goes to the Notice of Proposed Assessment itself. The NPA says something very short and cryptic about the basis of the assessment or it refers to letters that have been previously issued. There is a need for balance. If it is not clear what the FTB is raising as an issue, the taxpayer should not be held to a standard of clarity. (*Arthur Andersen*, Transcript, pp. 59-60)

**Response:** It is not the department's intent to hold a taxpayer to a standard of clarity. Such an intent will only give rise to disputes over whether the taxpayer has properly set forth grounds or will not allow for clarification. The proposed regulation provides a specific right of perfection to a taxpayer if there is a lack of clarity in the original protest.

**Recommendation:** No change is required.

**Comment:** A taxpayer should be allowed to amend a protest after the hearing. Intervening changes during the pendency of a protest may give rise to new issues or grounds and authorities. (*Eric Coffill, Morrison & Foerster*, Transcript, p. 98)

**Response:** Typically hearings are held just prior to concluding the protest. If new questions or issues arise during the course of the hearing, it is generally appropriate to consider these issues in resolving the protest. However, the department needs the authority to bring protests to a conclusion, and taxpayers require notice that protests are not open-ended.

**Recommendation:** No change is required.

**Comment:** The proposed regulation's attempt to limit the grounds for a protest raises serious fairness concerns. When the FTB issues a deficiency assessment, it may apply the doctrine of offset to change the basis for the assessment at any time up until the notice of action is issued. However, the proposed regulation proposes to require the taxpayer to raise all issues in the original protest or be forever barred from raising them. This improperly tilts the playing field at the expense of taxpayers and should not be promulgated into California law. It is acknowledged that the proposed regulation does not impose an absolute bar on raising grounds after the taxpayer has filed its original protest. (*Morrison & Foerster*, I.A., "Fourth")

**Response:** The proposed regulation does not require taxpayers to raise all issues in the original protest or be forever barred. First, the statute, not the



regulation, sets forth the time requirement for a protest and contains the requirement that the grounds be specified. Second, the proposed regulations provide specific time periods where new grounds will always be allowed and provide for new grounds being accepted on a discretionary basis. Third, the failure to raise a ground in a protest does not prevent a taxpayer from raising it in an appeal from the department's action in denying a protest. Fourth, even if a protest is not filed, a taxpayer may still raise any issue it wishes in a claim for refund.

There should be no fairness concerns. If the department does not make an assessment within the statutory period, there can be no obligation for additional tax. The statute of limitations closes with the passage of time. A protest does not keep it open. At the very least, the department cannot assess any additional tax. The most it can do is change the basis of its assessment. The taxpayer, on the other hand, is not limited to a single review of the assessment if it invokes the protest process. If the taxpayer disagrees with the department's conclusion with respect to the protest, it can file an appeal with the State Board of Equalization. In that appeal, the taxpayer is not limited to the grounds raised in the protest. In addition, the taxpayer has the option whether it files an appeal from action on the protest. The taxpayer may pay the amount of tax and pursue a claim for refund and appeals to either the State Board of Equalization and/or the courts from a denial of the claim.

**Recommendation:** No change is required.

**Comment:** The proposed regulation does not limit the authority of the FTB to raise additional or alternative grounds. The FTB should not be allowed to reopen an audit at protest. Either the restriction on taxpayers submitting new or alternative grounds should be eliminated or a similar limitation should be adopted that is applicable to the FTB. (*Deloitte & Touche*, Transcript, pp. 52-54)

**Response:** The proposed regulation implements a statute that grants protest rights to a taxpayer. It does not provide limitations on the ability of the department to determine the correct amount of tax for a period. If the protest raises grounds that were not addressed in the audit of the taxpayer, the department should have the opportunity to respond to those grounds and any related issues that may be raised by them even if they are new.

**Recommendation:** No change is required.

**Comment:** This subsection should be modified to state that the FTB is also limited to the grounds for the adjustment stated in the audit. (*Deloitte & Touche*, Transcript, pp. 53-54)

**Response:** The statute deals with the taxpayer's right to protest and the taxpayer's duties. The underlying statute does not discuss the department's rights and obligations. The department cannot increase an assessment beyond

the amount in the Notice of Proposed Assessment. If additional amounts are to be assessed, a new Notice of Proposed Assessment would be required subject to the appropriate statute of limitations. To the extent the taxpayer raises issues outside those involved in the audit and the Notices of Proposed Assessment, this may give rise to new issues to be pursued by the department.

**Recommendation:** No change is required.

**Comment:** No limitation on ability of FTB to raise new issues (*Hochman, Salkin, Rettig, Toscher & Perez P.C.*, p. 2; *Arthur Andersen*, Transcript, p. 59)

**Response:** The right to file a protest is conferred upon the taxpayer by Revenue and Taxation Code 19041. It is the taxpayer that is subject to any limits imposed by the statute. This statute does not speak to any limitations on the Franchise Tax Board. It is therefore inappropriate to propose such limitations in conjunction with a regulation dealing with Protests.

The ability of the Franchise Tax Board to propose assessments is set forth in Sections 19031 through 19034. Section 19034 requires a notice to set forth the "reasons for the proposed deficiency assessment and the computation thereof." Sections 19057, et seq., set forth the periods of limitation on proposing deficiencies. To the extent these sections impose limitations upon the Franchise Tax Board from raising new grounds, they do so independent of Section 19041. Once a proposed assessment has been issued, and the statute of limitations has run on issuing a new Notice of Proposed Assessment, the Franchise Tax Board cannot increase the amount of tax proposed to be assessed or propose a new assessment.

A taxpayer can defend against the proposed assessment on any grounds. It does not have to be related to the proposed assessment. The raising of new grounds by the taxpayer may lead to additional inquiries and raise new issues that the department should be allowed to pursue. In addition, the taxpayer has pre-payment review rights through the filing of an appeal with the Board of Equalization.

Finally, the taxpayer can pursue the matter after payment by the filing of a claim for refund. In the latter situation, the Franchise Tax Board can defend against allowing the refund on any basis. Maintaining a level playing field suggests that the Franchise Tax Board should not be limited in defending against a Protest of a proposed assessment. The taxpayer continues to have rights to contest that determination even if other grounds are raised.

**Recommendation:** No change is required.

**Comment:** What criteria will the department employ in determining whether the grounds are consistent with timely and efficient tax administration? (*Ernst & Young LLP*, p. 2)

**Response:** Facts and circumstances.

**Recommendation:** No change is required.

**Comment:** The proposed regulation provides the FTB with "liberal" discretion to grant a taxpayer's "request" to provide new or alternative arguments. But why should a taxpayer have to make such a request? A taxpayer should be allowed to present all issues, old and new, before the FTB issues the Notice of Action. On a practical note, many practitioners put a statement on their protest letters "reserving the right" to present new issues as they are identified or as they unfold during the resolution period. (*Spidell Publishing, Inc.*, p.3, Attachment 19041)

**Response:** The statute provides a time sensitive requirement for the filing of a protest and a requirement that the grounds be specified. The purpose of the taxpayer making a request to provide new or alternative grounds is to give the department notice that it is being done. The department agrees that it would like to have all issues, whether old or new, presented in the protest, but there must be an end. Is a protest to remain open forever so that new issues can be added that might arise? Attempting to add these issues after the department has developed the issues originally raised and is ready to act upon the protest does not lead to efficient administration.

**Recommendation:** No change is required.

**Comment:** Language should be added indicating that the failure to raise an issue on protest does not constitute a waiver with respect to an issue for purposes of an appeal or a claim for refund. (*Bob Rubin*)

**Response:** There is no language in subsection (e), or any place else in the proposed regulation, which states or suggests that an issue must be raised in a protest in order to have a right of appeal to the State Board of Equalization or to file a claim for refund.

The determination of whether the State Board of Equalization has jurisdiction to consider an issue in an appeal is a matter to be determined by the State Board of Equalization. It is not the practice of the department to assert that the State Board of Equalization does not have jurisdiction to hear an appeal because an issue was not raised in a protest. If this is a proper matter to be considered in an FTB regulation, it would be more appropriately addressed in regulations adopted pursuant to Sections 19045 or 19046 of the Revenue and Taxation Code. There is no language in Section 19045 which limits the grounds of an appeal similar to the language in Section 19382 regarding suits for refund which limits the ground for a lawsuit to that stated in a claim for refund.

Similarly, Section 19322 relating to claims for refund contains no limitation on the grounds which can be raised in a claim for refund to those stated in a protest.

There is not even a requirement that a protest be filed. Time limitations do exist with respect to the filing of a claim for refund, which thereby limit the time in which an issue can be raised.

**Recommendation:** It is recommended that language be added as a new subsection indicating that there is no prejudice to an appeal from a denial of a protest or in filing a claim for refund.

**(e)(3)**

**Comment:** What "alters an objection"? Would a "new ground" include a new theory on an issue that has been protested? Are grounds lumped into categories such as conformity, tax base, factors or precise issues and what procedures ensure consistent interpretation. (*Arthur Andersen LLP*, pp. 4-5; *Arthur Andersen*, Transcript, pp. 66-67)

**Response:** Grounds are not lumped into categories and there is no requirement of precision as to the statement of grounds. Protests are filed by individuals with little expertise in taxation and by highly qualified professionals specializing in tax matters. The proposed regulation must address the needs of the least sophisticated and should not be overburdened with sharply defined standards which are likely to cause confusion and become a battleground for separate procedural disputes unrelated to the substantive issue of the protest. This subsection was provided to allow for the liberal introduction of new grounds. This particular subsection will be construed in that manner. It is not the department's intent to have any of these provisions give rise to disputes, and it is this philosophy that should guide application of the proposed regulation. Management review of any decisions in this area will be made with the goal of consistent application.

**Recommendation:** No change is required.

**Comment:** It is unclear what is meant by the terms "new ground" or "alters an objection." Does altering an objection mean any alteration of the original protest? (*Cal-Tax*, p. 3, Section 19041(e)(2), Grounds for Filing a Protest; *Dave Doerr*, Transcript, p. 85)

**Response:** A new ground is at least a different ground. It is not something that clarifies or develops the original protest in a manner consistent with the original protest. The alteration of any objection would include any alteration of the original protest. An alteration is a change.

**Recommendation:** No change is required.

**Comment:** The word "further" should be inserted to modify the word "develop" in this subsection. (*Spidell Publishing, Inc.*, p.3, Attachment 19041)

**Response:** The word "further" is a word of limitation on develop. It was the department's view that it would be inappropriate to limit the development of a protest.

**Recommendation:** No change is required.

**Comment:** The definition of a "new, additional or alternative ground," adds nothing to the words themselves. The attempt to define this term may simply spawn further disputes. (*Morrison & Foerster*, I.A., "Fourth," p. 4)

**Response:** It was not the department's intention to spawn disputes over procedural aspects of the protest process. Staff does not believe this language will do so.

**Recommendation:** No change is required.

**(e)(4)**

**Comment:** Consideration should be given to including language allowing for amendments etc, if reasonable or good cause is shown by the taxpayer. (*Pillsbury, Madison & Sutro*, Comment 7, p. 2)

**Response:** A standard for the exercise of discretion has been provided in some instances. Many sections contain general intent language indicating that discretion is to be exercised liberally. Adding a more defined standard would probably make the proposed regulations appear more restricted and more formal. This is not the department's intent in drafting the proposed regulation. There is also no intent to create a framework which will lead to disputes over whether any standards provided have been followed. The issues involved with respect to protests should generally be the substantive tax issues or procedural issues involved with the issuing of proposed deficiency assessments. The proposed regulations should not give rise to a separate set of issues involving whether the procedures involved in the consideration of a protest have been followed. If a protest has not been properly handled by a departmental employee, the issues presented are ones of a managerial nature, not a substantive nature.

Neither section 19041, nor 19044, contains a reasonable or good cause exception to its provisions. Nonetheless, it does not appear to be unreasonable to add a reasonable or good cause exception.

**Recommendation:** Amend the proposed regulation to include a reasonable or good cause exception.

**(e)(4)(A)**

**Comment:** An amendment to a protest is allowed if the FTB requests that a taxpayer perfect the protest. It is unclear whether the FTB must request perfection specifically of the *grounds* for the protest to allow amendment of the grounds, or whether a request to perfect in any circumstance allows for amendment of the grounds. If the regulations contemplate that the FTB's request must specifically refer to the grounds to allow amendment of the grounds, it is questioned whether FTB would ever make such a request. (*Morrison & Foerster*, I.A, bottom, p. 3 "First")

**Response:** The proposed regulation provides for the right to amend the grounds whenever there is a request to perfect. There is no limitation on the right to amend to only those circumstances where there is a request to perfect the grounds. If there is no limitation expressed there should be no limitation read into the proposed regulation. In addition, staff believes that even if there were a limitation, this would not influence its decision as to whether to ask for perfection as to grounds. As has been pointed out, if there is a failure to fully articulate the grounds on which a protest is based, a taxpayer still has the right to an appeal to the State Board of Equalization or to pursue the claim for refund process.

**Recommendation:** No change required.

**Comment:** Eliminate the provision that new issues must be raised 60 days prior to the oral hearing. The proposed regulations provide that the FTB has the discretion to inquire into or allow the introduction of new, additional or alternative grounds and that this discretion is to be liberally construed. Few decisions are made at the time of the oral hearing and therefore the elimination of the 60-day provision would not have a significant impact. Furthermore, the State Board of Equalization frequently allows any and all relevant information (including new, additional or alternative "grounds") to be introduced in deficiency matters at just about any time. In this regard, the rules and regulations of the Franchise Tax Board should not ignore the practice and procedures of the Board of Equalization. The entire process must be designed to provide fair, reasonable, and meaningful review of all relevant information. (*Hochman, Salkin, Rettig, Toscher & Perez P.C.*, p. 2)

**Response:** The Protest process is a timed process. In order to invoke it, a Protest must be filed within 60 days and specify the grounds upon which it is based. Allowing a taxpayer to add grounds beyond those specified in the Protest is, arguably, beyond the statutory authority granted by the section, but appears to be an appropriate exercise of administrative discretion. Choosing to exercise administrative discretion does not mean that the exercise must be unfettered. The 60-day period, particularly since taxpayers are put on notice with respect to the period by the regulation, appears to be a reasonable limitation. In most circumstances, hearings are held after there has been an exchange of correspondence and are similar to a trial or appellate hearing. The case is completed but for the decision. The hearing allows for oral presentations and

questioning to make sure there is a complete understanding of position. If there is not, it is, of course, proper to allow for additional material to be presented.

The Board of Equalization's practices generally allow for only limited and specific material to be submitted after hearing. Only rarely would this encompass an issue that had not previously been raised.

The regulation goes on to allow the department the discretion to accept amendments submitted less than 60 days prior to the hearing. Other parts of the regulation indicate that this discretion is to be liberally exercised. There is no intention to make this section more restrictive. In response to other comments, the staff recommends that the period be reduced to two weeks.

**Recommendation:** Allow submission of new grounds as a matter of right within two weeks of the hearing.

**Comment:** The proposed regulation allows a taxpayer to amend its grounds if the request is made more than 60 days prior to the hearing. If a taxpayer makes a request less than 60 days prior to the hearing, it is in the FTB's discretion as to whether to allow an amendment. Typically a taxpayer receives only 30 days notice prior to a hearing. Proposed Reg. 19044(d)(2). Thus when a taxpayer receives a notice of hearing it is already too late to amend the grounds. It would be more fair to notify the taxpayers of a hearing while there was still time to amend the grounds for the protest. (*Morrison & Foerster*, I.A., "Third," p. 4)

**Response:** Proposed regulation 19044(d)(2) provides that the notice shall be mailed at least 30 days prior to the hearing. This is not necessarily the typical period of time, but a minimum time period. The department also has the discretion to allow an amendment submitted less than 60 days prior to the hearing. Nonetheless, the staff agrees that there is merit to the comment and the taxpayer should, as a matter of right, be allowed to amend the grounds of a protest after the notice of hearing has been mailed and prior to the date of the hearing. This would not limit the department's discretion to grant an amendment in other circumstances.

**Recommendation:** Provide, as a matter of right, that a taxpayer may amend the grounds of its protest up to two weeks prior to the date of the hearing. At a minimum, this will allow a taxpayer at least one-half the time between the scheduling of a hearing and the hearing itself to amend the protest.

#### **(e)(4)(B)**

**Comment:** There should not be a limitation on the submission of new grounds at oral hearing. (*Ernst & Young LLP*)

**Response:** Section 19041 of the Revenue and Taxation Code provides a taxpayer with a 60-day period for filing a Protest "specifying the grounds upon which it is based."

Section 19041 of the Revenue and Taxation Code closely parallels the language of Section 19322 of the Revenue and Taxation Code which allows for claims for refund and states that the claim "shall state the specific grounds upon which it is founded." Both judicial and administrative construction of the Claim for Refund section have found this language to establish limitations upon what issues can be raised by a taxpayer in trying to obtain a refund. The Claim for Refund section is also time bound, although for a period of time different than the Protest section.

Section 19041, standing by itself, limits a taxpayer to the grounds which it "specifies" within a 60-day period from the issuing of a Notice of Proposed Assessment. When it is compared to the parallel language of Section 19322 and the judicial and administrative interpretation of that section, the conclusion that the statute imposes a limitation on grounds is buttressed.

It has been the general practice of the Franchise Tax Board to allow new issues to be raised in the context of a Protest. It appears that this practice is not based upon the statutory language but on administrative convenience and the exercise of discretion. The regulation has been drafted to allow the department to exercise discretion. It has been our experience that it is advantageous to taxpayers and the administration of the tax laws to resolve issues at the lowest level possible in the administrative process. The proposed regulation provides specific instances in which new issues will be allowed to be raised in order to provide some assurance to taxpayers. In addition, the regulation contains language which indicates that the staff will be liberal in exercising discretion in allowing for the introduction of new issues. Staff believes that this is all that the statute allows.

Staff is also concerned with circumstances where taxpayers raise issues for the first time after the original grounds and surrounding facts have been developed. This can happen without regard to the amount of time that the case has been under Protest. This appears to be inconsistent with the Protest statute itself. The Protest process contains a time limit for its initiation. It functions as any other statute of limitations; it is intended to operate so that matters are resolved relatively quickly. The introduction of issues after the Protest has been filed, and in particular after inquiries have been made in an effort to resolve the issues which have been raised, impedes the timely resolution of cases.

**Recommendation:** No change is required.

**(e)(4)(C)**

**Comment:** A taxpayer requesting an oral hearing generally will be entitled to amend its grounds, but a taxpayer who has not requested an oral hearing can amend only in the FTB's sole discretion. This distinction is arbitrary and unfair.



We question why the regulations should preference taxpayers who had the foresight to request a hearing over those taxpayers without it. (*Morrison & Foerster*, I.A., "Second," pp. 3-4)

**Response:** The reason for the distinction between the taxpayers who requested a hearing and those who did not is that taxpayers requesting a hearing will be contacted by the department prior to action on their protest, while if a hearing is not requested, it is possible that action may be taken with no further contact with the taxpayer. It should also be noted that the period for allowing the amendment of a protest in the discretion of the department extends up to the date of the Notice of Action, which is more liberal than in the case of where a hearing was requested where the time for the exercise of discretion is less than 60 days prior to the hearing.

**Recommendation:** No change required.

**Comment:** The proposed regulation should state that "the FTB should exercise its discretion liberally" rather than "the department's discretion in this respect should be liberally construed. . . ." (*Morrison & Foerster*, I.A., "Second," p. 4)

**Response:** Staff agrees that this suggestion increases clarity.

**Recommendation:** Make the change requested.

**Comment:** By the last sentence of the subsection, a taxpayer is required to submit appropriate facts and authorities in support of a request to raise a new, additional, or alternative ground. However, there is no mention that a taxpayer must make a request to submit a new, additional or alternative ground. (*Spidell Publishing, Inc.*, p.3, Attachment 19041)

**Response:** The title of the subsection is "Requests to amend." and the second word of the first sentence of (e)(4) is "request." There is a mention of the fact that a request must be made.

**Recommendation:** No change is required.

#### (e)(5)

**Comment:** What happens if you label the document a claim for refund and a protest? (*Arthur Andersen LLP*, p. 5)

**Response:** The document will be recorded both as a protest and a claim for refund, and the procedural standards for each document will be applied. Labeling a document as a claim for refund should not be allowed to trigger the deemed denial, see Section 19331 Revenue & Taxation Code, to avoid

participation in the protest process. Whether it would or not is a decision that would be made by the appropriate adjudicatory body.

**Recommendation:** No change is required,

**Comment:** This section appears to attempt to address the conversion of a protest to a claim for refund by payment. It should be clear that an amendment to a protest while the statute for a claim for refund is open constitutes an amendment which will be allowed as a claim. The proposed language appears to change the law in this regard and to that extent would be invalid. The proposed language may be a trap for the unwary. The section should be deleted. (*Morrison & Foerster*, "Finally," p. 5, erroneously referring to (d)(5))

**Response:** The intent was to put taxpayers on notice that amending the grounds of a protest would not be a means to circumvent the claim for refund statute period. An amendment to a protest converted to a claim for refund made prior to the running of the period for filing a claim for refund would not be invalid. An amendment made after the period for filing a claim for refund would not be accepted as part of a claim. The section should not be deleted; it is possible that it requires clarification.

**Recommendation:** Clarify the language of the section.

**Comment:** It is unclear what this paragraph accomplishes. (*Pillsbury, Madison & Sutro*, Comment 6)

**Response:** A taxpayer can convert a protest to a claim for refund by payment of the proposed deficiency, Section 19335 Revenue & Taxation Code. A claim for refund is subject to its own time constraints and limitations on the issues which can be raised. In some cases, a document filed as a protest can have claim for refund implications, even without the payment of any of the proposed deficiency, because the issues involved would result in a tax change greater than that proposed as the result of audit adjustments. This paragraph was intended to prevent arguments that the adding of a new issue after a protest was filed and payment was made could be used to circumvent the issue preclusion effect of the claim for refund statute.

**Recommendation:** Clarify the language in the proposed regulation.

#### **(e)(2)-(4)**

**Comment:** These provisions relating to a taxpayer's submitting additional or alternative grounds should be eliminated from the [proposed] regulation. In the alternative, the FTB could request that the taxpayer sign a statement that any delays in completion of the protest caused by the addition of, or introduction of

additional or alternative grounds, are the responsibility of the taxpayer. (*Deloitte & Touche*, Transcript, p. 53)

**Response:** The provisions are appropriate and are consistent with the statute. It is not clear what purpose would be accomplished by submission of the statement suggested by the commentator.

**Recommendation:** No change is required.

**Comment:** These sections should be deleted. If they are not deleted they should be clarified by specifying that a failure to assert grounds in a protest will not prejudice the rights of a taxpayer to raise any additional grounds on appeal before the State Board [of Equalization] or a claim for refund. (*McDonough and Allen*, Transcript, p. 57)

**Response:** Section (2) is appropriate because the statute establishes a time-sensitive period for the filing of a protest and specifying grounds. Section (3) provides definitions and section (4) provides exceptions.

The proposed regulation deals with protests not with appeals to the State Board of Equalization or the filing of claims for refund. It is not appropriate for the department to speak to requirements regarding appeals to the State Board of Equalization. However, a provision can be added to subsection (e) indicating that failure to raise a ground in a protest does not prejudice rights to file an appeal on a ground with the Board of Equalization or to file a claim for refund.

**Recommendation:** Add a paragraph (6) to the proposed regulation indicating that failure to raise a ground in a protest does not prejudice rights before the State Board of Equalization or with respect to a claim for refund.

#### (e)(2)-(5)

**Comment:** These sections should be stricken or rewritten entirely. A taxpayer has the ability to raise new, additional and alternative grounds in a claim for refund, notwithstanding the fact that these grounds were not raised in an original protest. There is no sound reason to restrict the administrative process to the original grounds set forth in the protest since this can be cured by paying the tax and filing a claim for refund and raising any and all new grounds. This is the procedure which has been applied by the Franchise Tax Board for years and which should continue to be applied. It makes no sense to require a taxpayer to have to go through the various requests to amend etc. set forth in the proposed regulation since the taxpayer has the right to do so by filing a claim for refund. (*Pillsbury, Madison & Sutro*, Comment 5)

**Response:** The filing of a protest is a time-sensitive administrative remedy. The taxpayer has 60 days to file the protest. The statute provides that the

protest shall specify the grounds. There is nothing in the statute which allows for an amendment of the grounds or the extension of the period for filing a protest.

There is a significant difference between the filing of a protest and the filing of a claim for refund. The former can be done without paying the tax and the latter is premised upon the payment of the tax. In the case of a claim for refund, there is also a period for filing the claim which is specified by statute and a requirement that the grounds be specified in the claim. In the case of a claim, it is clear that the taxpayer is limited to the grounds set forth in the claim. The language is virtually identical in the two sections and should be construed in an identical manner. It could be argued that in the case of the claim for refund there is a greater inequity in limiting the taxpayer to the grounds stated because of total preclusion from having an issue considered. As pointed out in the comment, such a preclusion does not exist with respect to a protest because of the ability to pursue other issues through the claim for refund process.

The department also recognizes that the protest is the first step in the resolution process, that it is generally more efficient to resolve cases at the lowest level possible, and that the taxpayer has additional opportunities to raise other issues, if not at the protest level, then in the succeeding levels. As a consequence, the department has historically allowed for the introduction and consideration of other issues after a protest has been filed. The proposed regulations continue to allow for this to occur. First, rules have been provided which provide a taxpayer with absolute rights to introduce new issues in described circumstances. Second, the department is given discretion to allow for the introduction of new issues beyond those where it is guaranteed. Third, the proposed regulation provides that this discretion will be liberally exercised. Nonetheless, the department does need the ability to terminate a protest proceeding at some point; otherwise, it is conceivable that a protest could be extended virtually indefinitely by the submission of new issues just as the department was preparing to act upon the protest. The department does not anticipate that the adoption of the proposed regulation will result in a material change in its practice.

**Recommendation:** No change is required.

(f)

**Comment:** The grant of a right to "perfect" a protest will substantially slow the process, and it lacks certainty for the taxpayers and is susceptible to abuse. In conjunction with the myriad of unnecessary requirements of form and content, this section could result in an endless maze of bureaucratic red tape for taxpayers, and no demonstrative reason has been established to support it. All that is required by the statute is that a protest be in writing, that it protest a particular NPA, and that it sets forth the grounds on which the protest is made. (*Cal-Tax*, pp. 3-4, Section (f), Perfecting a Protest; *Dave Doerr*, Transcript, pp. 85-86)

**Response:** The requirements listed include a statement as to what is being protested, why it is being protested, and that the protest is being filed by someone with authority to do so. Supplying the requested items should not slow the processing of a protest.

The information requested is: (1) the name(s) of the taxpayer; (2) the taxpayer's identification number; (3) an address; (4) the amount being protested; (5) the year(s) involved; (6) the number on the Notice(s) of Proposed Assessment; (7) the date on the notices; (8) the basis for any assertion that the Notice(s) were mailed a date different than that on the notice; (9) a signature; and, (10) a statement of grounds and reasons. This information is necessary to identify the taxpayer and to establish the years and basis for the protest. All should be readily determinable by the taxpayer.

**Recommendation:** No change is required.

**(f)(2)**

**Comment:** The time for perfection is not clear. The Franchise Tax Board should be required to notify the taxpayer if it believes the protest has not been perfected. What if the Franchise Tax Board tries to kick out a protest which has not been perfected and the 60-day period has run. (*Arthur Andersen*, Transcript, pp. 67-71)

**Response:** The organization of the subsection does not allow the department to reject an unperfected protest. In order for it to do so it must notify the taxpayer and give them the opportunity to perfect. The 60-day period applies to a taxpayer's own determination that it needs to perfect the protest. It has no relevance to a department determination that a protest needs to be perfected.

**Recommendation:** No change is required.

**Comment:** The references in this subsection to subsection (e) are extremely confusing. The most fundamental problem is how subsections (e) and (f) of the proposed regulation interact. (*Morrison & Foerster*, B., p. 5)

**Response:** Subsection (e) of the proposed regulation deals specifically with the grounds for a protest. Subsection (f) deals with the elements of the protest as required by subsections (2), (4) and (5) of subsection (d). Subsection (e) of the proposed regulation sets forth some proposed rules that take precedence over subsection (f)'s rule if there is a conflict.

**Recommendation:** No change is required.

**(f)(2)(A)**

**Comment:** It is unclear what consequence occurs if the perfection of an "invalid protest" occurs more than 60 days after the mailing of the Notice of Proposed Assessment. Does the perfection "relate back" to the original filing? (*Cal-Tax*, p. 4, Section (f) Perfecting a Protest; *Dave Doerr*, Transcript, p. 86)

**Response:** The department must review a protest prior to acting upon it. If the department determines that a protest needs to be perfected, it "shall notify the taxpayer . . ." (f)(3)(A). The taxpayer then has the opportunity to perfect. If the taxpayer does not perfect the protest, it will be acted upon, in all likelihood denied, as if it were a valid protest, (f)(4). This will allow a taxpayer to appeal to the State Board of Equalization.

The perfection "relates back" to the original filing. This does not allow a taxpayer to cure a filing that was not timely. It allows a taxpayer to cure other defects in a protest. It also does not allow a taxpayer to request a hearing as a matter of right. The right to a hearing is not a requirement for a valid protest.

**Recommendation:** No change required.

**(f)(3)(A)**

**Comment:** Section (f) does not make clear whether the FTB may wait until the expiration of the 60-day period and then reject the taxpayer's protest for lack of determination of need. A provision should be added which would require the FTB to notify the taxpayer if it believes the protest has not been perfected. (*Arthur Andersen LLP*, p. 6)

**Response:** The department may not reject a protest for lack of all the elements unless it notifies the taxpayer and gives the taxpayer a right to perfect. Proposed subsection (f)(3)(A) states that the department "shall notify" the taxpayer. The duty is a requirement that is not time bound. It arises even if a review is done after 60 days has elapsed.

**Recommendation:** No change is required.

**Comment:** Would a taxpayer be prohibited from perfecting a protest if the FTB does not notify it of a need to perfect? For example, if a taxpayer wishes to add a taxpayer identification number after 60 days have elapsed, can it only do so after a request by FTB? (*Morrison & Foerster*, B. "Third," p. 6)

**Response:** No. See (f)(2)(A). In addition, the example given, the lack of a taxpayer identification number, may make it impossible to properly identify a protest if there were more than one Notice of Proposed Assessment issued to a taxpayer with the same name. This is a correction the FTB would probably have to request in order to act on the protest.

**Recommendation:** No change is required.

**Comment:** Is the FTB required to identify specifically the information a taxpayer can provide in perfecting a protest, or can a taxpayer supplement with any information it believes is missing? (*Morrison & Foerster*, B., "Third," p. 6)

**Response:** The taxpayer must perfect to the extent requested. It may perfect as to any other areas except as to adding grounds. It may provide information and legal authorities in addition to those originally supplied, (f)(3)(D).

**Recommendation:** No change is required.

**Comment:** Does FTB notification that a protest is incomplete automatically allow the taxpayer to add grounds? Only if the grounds are missing? Not at all? (*Morrison & Foerster*, B., "Third," p. 6)

**Response:** The request to perfect does not automatically allow for the adding of grounds. It will allow for the adding of grounds if no grounds are included. That is the purpose of the language referencing subsection (e).

**Recommendation:** No change required.

### **(f)(3)(B)**

**Comment:** Does (f)(3)(B) qualify the right in (f)(2)(A) to perfect a protest? Subsection (f)(2)(A) states that a taxpayer who has not requested an oral hearing may perfect its protest within 60 days of filing it. Subsection (f)(3)(B) provides that a need to perfect a protest does not arise unless and until the taxpayer is notified by mail that the original protest needs to be perfected. Does (f)(3)(B) qualify the unrestricted right of (f)(2)(A)? Will the FTB ever notify a taxpayer of a need to perfect? (*Morrison & Foerster LLP*, pp. 5-6)

**Response:** Subsection (f)(2)(A) and (f)(3)(B) address two different circumstances. Subsection (f)(2)(A) gives an unrestricted right to perfect. Sometimes taxpayers file protests at the end of the 60-day period to prevent the running of the time period with the intention of completing the protest subsequently. Subsection (f)(2)(A) addresses that circumstance.

Subsection (f)(3)(B) addresses the circumstance where the taxpayer may believe it has provided all of the necessary items and FTB determines that the requirements of subsection (d) have not been met. It was put there so that a protest can be perfected when FTB requests information. Subsection (f)(2)(A) provides taxpayers with a right, not a requirement. Subsection (f)(3)(B) states the taxpayer does not have to perfect unless the FTB determines there is a need to perfect and guarantees the taxpayer notification and a guarantee against

summary action on the protest. The FTB will notify the taxpayer of a need to perfect whenever it sees one. Subsection (f)(3)(B) expands the period in which a protest can be perfected.

**Recommendation:** No change needed.

**(f)(3)(C)**

**Comment:** What constitutes valid grounds for obtaining an additional extension? (*Arthur Andersen LLP*, p. 6)

**Response:** No statement was made as to what grounds would be accepted for an additional extension in order that there would be no limitation, either expressed or implied. For example, in the case of an individual taxpayer who was traveling outside the country, it might be reasonable to grant an additional extension. If the individual were represented by an accounting firm or a law firm, it would be less reasonable. Decisions will be made on a "facts-and-circumstances" basis. It should be kept in mind that the areas where perfection can be requested are limited and do not appear to impose a significant burden, other than perhaps the statement of the grounds of the protest.

**Recommendation:** No change is required.

**Comment:** There are sometimes complex issues involved in examinations. Many times the years are old years for which the source data is in storage. Other times the information is contained in files of a predecessor corporation, or the personnel familiar with an issue are no longer on the staff of the taxpayer. The time for a taxpayer to respond should be longer than 30 days or the 45 days with the automatic extension. (*Ernst & Young LLP*, p. 5)

**Response:** The proposed regulation sets forth a minimum time that a taxpayer is guaranteed. It does not require the department to limit the time to that amount, and there is no limit on how much time can be allowed. The comment assumes the 30 days and extension to be limitations as to what will be allowed. The department believes these are guarantees as to what will be allowed and places no limitation on what can be allowed. Facts and circumstances will support longer time periods.

**Recommendation:** No change is required.

**(g)**

**Comment:** The entire subdivision needs to be clarified. It must be kept in mind that the hearing officer is not a judge and that the attempt to raise the procedures to another level of formality is inappropriate. For example, it is the practice of the Franchise Tax Board to have the hearing officers, in many instances, argue the



case against the taxpayer at the State Board of Equalization upon appeal. (*Pillsbury, Madison & Sutro*, Comment 8)

**Response:** The intent of the department with respect to subsection (g) is to describe what is likely to occur at the protest level. The department frequently requests additional information during the course of a protest proceeding. The information would not be requested if the hearing officer did not think it was relevant to the determination of the protest.

It is the department's position that the taxpayer has a duty to respond. The department believes it should provide the taxpayer with a time frame when the response is expected but recognizes that extensions of time may be necessary. The department believes it is appropriate to advise taxpayers of the consequences of a failure to respond. The department is not seeking additional authority for these consequences through the regulation.

To the extent that formality has been introduced into the process, this has been done to provide specific guarantees to taxpayers as to their rights and time frames.

The hearing officer is charged with the responsibility of resolving the protest. A determination must be made by the hearing officer for the case to be passed onto another level, if that is appropriate. It is not clear what significance should be attached to whether or not the hearing officer argues an appeal from a protest before the State Board of Equalization.

**Recommendation:** No change is required.

**Comment:** Proposed subsection (g) grants the FTB specific authority to request additional information or authorities regarding the grounds raised in the protest. This subsection should be modified to state that the FTB may not request additional information or authorities that would relate to grounds not raised by the auditor in the audit or by the taxpayer in the protest. (*Deloitte & Touche*; *Deloitte & Touche*, Transcript, p. 54)

**Comment:** Requests for information should be limited to those related to the taxpayer's issues raised in the protest. In some cases, information requests, in essence, amount to a "re-audit of the issue to come up with additional information and basically do the job the auditor should have done." The FTB should fully develop its position in the field and should base its position on the information developed and provided by the auditor. If the information is not fully documented or presented by the auditor, the FTB protest officer should not be able to go out and request additional documentation to try to support that. The protest should be decided on the information in the audit file and on the protest developed by the taxpayer. (*Deloitte & Touche*, Transcript, pp. 54-55)

**Comment:** Occasions have occurred where the FTB has asked for information that did not directly relate to the grounds raised in the protest. Rather, this

information would provide additional support for the arguments made by the FTB auditor in the audit report and NPA. In some instances, the information requests amount to a "re-audit" of the issues. We believe the FTB auditors have the responsibility to fully develop their positions on audit. The auditor in the field has access to taxpayer information and files. The audit report is reviewed before an NPA is issued. The FTB should base its position on the information developed and presented by the auditor, the FTB protest officer should not be attempting to obtain additional audit support. The protest should be decided on the information in the audit file and the information submitted by the taxpayer. (*Deloitte & Touche*, Transcript, pp. 54-55)

**Response:** Subdivision (g)(1) provides that the department may request information or authorities "regarding the grounds raised in the protest filed . . . ." It is not clear what additional limitation might be needed. This in fact may raise issues with respect to new grounds being asserted by taxpayers or the department and whether any requests are appropriate in those circumstances. The department does not believe that this provision establishes an absolute prohibition on requesting other information.

It may be difficult to determine specifically to what grounds a request for information or authorities relates. Raising new grounds may also raise new issues that relate to those grounds or to requests for new information. Attempting to place limitations on FTB requests could create a whole new area of procedural disputes as to whether requests are proper and questions as to what the sanctions should be if the requests are improper in someone's mind. On occasion Notices of Proposed Assessment are issued because the taxpayer has refused to supply requested information or allow an audit to be properly performed. In those circumstances, any limitation on requests for information would be inappropriate. Placing limitations such as those suggested would provide taxpayers with a blueprint for avoiding full and proper audits.

A taxpayer may raise a new issue or ground in its protest. The raising of an issue or a ground different from that in a protest may open up other areas that should be explored. The FTB should have the power to conduct this investigation.

Even if the protest is limited by the taxpayer to the issues upon which an audit adjustment is based, the adjustment may have been made because the taxpayer refused to supply information. In those circumstances, it would be inappropriate to limit the protest hearing officer to only the information that taxpayer determines to supply in its protest. The purpose of a protest hearing is to allow for the exploration of issues and the exploration of the circumstances of the adjustment so that a proper result can be reached. Placing limitations on requests for information and authorities will give rise to procedural disputes that have little to do with the merit of the protest and the adjustment.

**Recommendation:** No change is required.

**Comment:** The duty to respond to information requests should be limited to those requests which are reasonable. The regulation does not impose any such limitations upon the request. (*Richard E.V. Harris*, Item 13; *Pillsbury, Madison & Sutro*, Comment 9)

**Response:** This standard was not included in the proposed regulation because it was generally thought by the department to be unnecessary, and there was no intent to create a series of procedural issues as to whether the protest process was being conducted appropriately. The articulation of a standard sometimes invites challenges as to whether the standard has been complied with during the process. It also invites establishing a consequence for failing to abide by a standard.

**Recommendation:** No change is required.

**Comment:** If subpart (g) is to be retained in any form, it should expressly provide for a "Protections For Taxpayers Who Have Filed A Protest" section that, at a minimum, contains the following: 1) department personnel shall not impose any unnecessary or unreasonable burdens on a taxpayer who has filed a protest; and 2) department personnel shall not attempt to influence a taxpayer who has filed a protest to abandon, compromise or settle the protest or issue by any improper means, including without limitation the use of delays, unreasonable requests for information, or the imposition of any unnecessary burden. Without express protections for the taxpayer clearly articulated, the increased procedural formality reflected in subpart (g) is likely to generate further mistrust. (*Richard E.V. Harris*, Item No. 14; *Richard Harris*, Transcript, pp. 38-39)

**Response:** The subject matter of the proposed regulation is the filing of a protest. It is not the conduct of the employees of the Franchise Tax Board. The department agrees that all matters should be handled in the manner described, but this proposed regulation is not the appropriate place to include such rules.

Many, if not all, of the statements requested are contained in the department's "Statement of Principles of Tax Administration." There is no need to repeat them in the proposed regulation. The need to state express protections that already exist is not apparent.

**Recommendation:** No change is required.

**Comment:** Taxpayers are entitled to know the factual and legal basis for the FTB's proposed assessments. The FTB's explanations regarding its proposed assessments are sometimes incomplete, contain inadequate descriptions of the factual bases and are inadequately supported by authority. Taxpayers often have a need for additional information from the FTB. The FTB's responses have frequently been untimely, nonexistent, incomplete or otherwise inadequate. Subsection (g) should be deleted or the regulation should contain a parallel provision allowing for taxpayer requests for information and authorities. This

provision should include similar time provisions and be expressly limited to reasonable requests. (*Richard E.V. Harris*, Item Nos. 15-18)

**Response:** The department agrees that taxpayers are entitled to know the factual and legal basis of proposed assessments, and they have a right to inquire into those. The subject matter of the proposed regulation, however, is the filing of a protest.

Sometimes the inadequacy of the department's knowledge arises from the failure of the taxpayer to respond to the auditor's requests for information. In those circumstances it would be unreasonable to place any limitations on the department's ability to ask questions or to impose requirements on the department to make responses.

Subsection (g) of the proposed regulation serves an appropriate purpose and puts taxpayers on notice that requests for information can be anticipated in order that the protest may be properly resolved. The department does not believe there is a need for a parallel subdivision allowing taxpayers to request information and authorities. They have the right to do so, and nothing in the regulation abrogates any of those rights.

**Recommendation:** No change is required.

**Comment:** Reaction to this section entitled "Request of Department for Additional Information or Authorities" illustrates why the FTB should expressly commit in this regulation to handle all taxpayer protest in a reasonable, fair and impartial manner. Increased procedural formality, no matter how reasonable it might appear to the FTB staff, can be perceived (often properly) as a potentially expensive, burdensome addition. It also illustrates fear of abuse. California is already perceived in many quarters as an overreaching, arbitrary taxing jurisdiction. The regulation should be limited to avoid exacerbating these perceptions. The public reaction should be seriously considered. It reflects a reasonable concern. Citation is provided to a 1998 *CFO* survey. (*Richard E.V. Harris*, Item Nos. 6-10)

**Comment:** There is a very reasonable fear that the FTB staff may use the new procedure to impose unreasonable burdens on taxpayers. There is a very reasonable fear that the FTB staff will otherwise use additional requests for "information" or "authorities" in an unreasonable manner. What express protections are provided in this regulation against that potential FTB staff conduct? (*Richard E.V. Harris*, Item Nos. 11 & 12)

**Response:** The increased procedural formality contained in the regulation was provided to set forth guaranteed rights and time frames so that matters may be resolved on substantive grounds and not for a failure to follow all of the procedures.

There are no expressed provisions in the proposed regulation to prohibit departmental staff conduct. These are matters that are more appropriately addressed by management in evaluating employees.

**Recommendation:** No change is required.

**Comment:** The FTB is granted the authority to simply determine the taxpayer's protest as "not complete." The practical consequence is that the FTB can commit the taxpayers' protest to administrative limbo, denying taxpayer any forum in which to pursue their claim. Such a process is directly contrary to the dictates of the Taxpayer Bill of Rights (see Section 21010 of the Revenue and Taxation Code). Such requirements that taxpayers provide, or even respond to, such information requests is beyond the scope of the authorizing statutes. (*Cal-Tax*, p. 4, Section (g), Request for Additional Information of Authorities; *Dave Doerr*, Transcript, p. 86)

**Response:** The FTB is granted the authority, Section 19045 of the Rev. & Tax. Code, to decide the protest. No one else is given any authority with respect to the protest. The department does not determine that a protest is "not complete." It may determine that the statutory requirements for a protest have not been met. Once the statutory requirements are met, the department then makes a determination on the protest. That determination may be based upon a failure of a taxpayer to show that the department's proposed assessment is in error because of the failure to submit necessary information.

The FTB has no interest in retaining cases in "administrative limbo." Cases in such a status do not result in any revenue to the state and remain in protest status. The taxpayer has the ability to discharge the protest from "administrative limbo" by paying the tax and converting it into a claim for refund which it can deem denied after six months. Section 19331 of the Revenue and Taxation Code. Section 21010 of the Revenue and Taxation Code requires the development of a plan to reduce the time taken to resolve protests, claims for refund and appeals. It does not establish specific time frames in which they must be resolved.

**Recommendation:** No change is required.

(g)(1)

**Comment:** It is not acceptable that the FTB be given broad discretion to initiate a fishing expedition for "additional information" or "authorities" for arguments not made by the taxpayer. There is no limitation on the reasonableness of the request for information. (*Cal-Tax*, p. 4, Section (g), Request for Additional Information of Authorities; *Arthur Andersen*, Transcript, p. 71-72)

**Response:** The purpose of a protest is to allow a taxpayer to attempt to contest the department's proposed assessment. The ability to request additional

information and authorities is designed to allow a hearing officer to attempt to fully develop a protest so an informed decision can be made on the merits and the correct amount of tax determined. Frequently, protests are filed by individuals who do not understand what information is necessary in order to resolve their protest. This section informs taxpayers that the department **may** request additional information.

The language in the proposed regulation describes requests for additional information as relating to "information or authorities regarding the grounds raised in the protest." The department believes this limitation is sufficient. No limitation on the reasonableness of the request for information was included in an attempt to preclude procedural disputes over what might be reasonable. A taxpayer can always contest whether a particular request is reasonable and refuse to supply the information on the grounds that the request is unreasonable. There are not separate sanctions provided for failure to provide information in the proposed regulation. Failure to supply information may result in resolution of the protest in a manner adverse to the taxpayer and may give rise to a failure to exhaust administrative remedies defense. If the taxpayer does not agree with the action of the department, it will have the opportunity to contest these determinations in subsequent proceedings before a third party.

**Recommendation:** No change is required.

**Comment:** This section needs significant clarification and amendment, as it puts pressure on the taxpayer and the FTB to anticipate what information may be requested during the hearing. Requiring all requests for information to be made at least 60 days prior to the oral hearing will alleviate this pressure. Requests should be specific and narrowly drawn to the precise issue. They should be in writing only. The FTB should not re-audit issues at protest. The availability of documents should be discussed before requests are made. (*Arthur Andersen LLP*, p. 7)

**Response:** The department believes that requiring that all requests for information be made 60 days prior to the hearing will create more pressure than allowing the requests to arise as the result of the discussion of the protest at a hearing. In many circumstances, it is not until an oral hearing is held that the department and the taxpayer understand the grounds upon which a protest is based and what information might lead to its resolution. The protest process is intended to be informal in nature. Placing rigid requirements on the timing of the requests for information and not allowing requests to be made orally is inconsistent with this informality. It should also be noted that proposed regulation 19044(h)(9) provides that the department will reduce any oral requests at a hearing to writing after the hearing. The availability of documents should normally be discussed in conjunction with a request or a response to a request. Facts and circumstances will determine the effect of the unavailability of documents.

**Recommendation:** No change is required.

**Comment:** A request can even be made during a hearing. (*Cal-Tax*, p. 4, Section (g), Request for Additional Information of Authorities)

**Response:** The purpose of the hearing is to allow the taxpayers and hearing officer to explore the issues raised by the protest. (Proposed Reg. 19044(h)(1).) A discussion of the protest with the taxpayer will frequently identify areas where additional information is needed. Requesting the information during the course of the hearing when it is identified is the appropriate time to make the request. Surely it would be more burdensome to require the taxpayer to submit all information prior to the hearing and forever thereafter bar them from submitting information.

**Recommendation:** No change is required.

#### (g)(2)

**Comment:** A statement on the duty to respond to requests for information is unnecessary. (*Spidell Publishing, Inc.*, p. 5, Attachment 19041)

**Response:** The regulation does nothing more than put taxpayers on notice that entry into the administrative process carries with it responsibilities. It adds no new duties, but it does tell taxpayers that the duty does exist. This is particularly significant if the protest process is used by unrepresented taxpayers who are unfamiliar with the process. Even some of the comments submitted by tax professionals in conjunction with the proposed hearing demonstrated the belief on the part of some that a protest should be decided based solely upon an audit report and the protest. These comments demonstrate the need for a specific statement regarding the duty to respond.

**Recommendation:** No change is required.

#### (g)(2)(A)

**Comment:** How will it be decided which cases get additional time? Who will make this determination? (*Arthur Andersen LLP*, p. 7)

**Response:** The determination as to how much time will be allowed to supply requested information is based upon the facts and circumstances of the individual case and the information being requested. It is hoped that it will be a decision reached by mutual agreement between the taxpayer and the protest hearing officer. Ultimately, the department needs to retain control over the timing. The 30-day time period was included to provide taxpayers with assurance that requests would not have a shorter time period unless they agreed to such period. A single extension of time is granted as a matter of right, see subsection (g)(2)(B), with a guaranteed period of time for the extension dependent upon the first period of time.

**Recommendation:** No change is required.

**(g)(2)(A), (B) & (C)**

**Comment:** The time frames for responding to the request are much too formal for the process. There is nothing in the statutes which provides for such a restrictive timetable. (*Pillsbury, Madison & Sutro*, Comment 9)

**Response:** The formality exists to provide protection to the taxpayer. The intent of having specific time frames was to provide protection to taxpayers by providing a minimum response time. The department believes it should provide the taxpayer with a time frame when the response is expected but recognizes that extensions of time may be necessary. The regulation contains no other limit as to what will be a reasonable time and specifically allows for agreement as to periods for response.

**Recommendation:** No change is required.

**(g)(2)(B)**

**Comment:** Is there a maximum length of time? (*Arthur Andersen LLP*, p. 7)

**Response:** No maximum length of time is specified. The request will presumably indicate the time desired. If no response is sent, it should be assumed the extension requested has been granted. If a different period of time for the extension is granted, there should be communication.

**Recommendation:** No change is required.

**(g)(3)**

**Comment:** We question the function and intent of the provision that failure to provided a timely and/or complete response "may give rise to an assertion by the department that the taxpayer has failed to exhaust administrative remedies in subsequent administrative or judicial proceedings." The language is superfluous because FTB can always so *assert*. Of course, a mere assertion by the FTB is only as effective as the facts upon which it is based. Moreover, the intent is misguided and confuses the concepts of burden of proof and exhaustion. FTB can conclude that failure to produce in a timely and complete way results in a failure to sustain a burden, but it cannot limit the rights before the State Board of Equalization and in a trial de novo. Of course, the FTB has no authority to do that. (*Morrison & Foerster, C.*, pp. 6-7, incorrectly referred to as (i)(3))

**Comment:** The issue of failure to exhaust is not an appropriate issue for the [proposed] regulations. (*Arthur Andersen*, Transcript, p. 58)



**Comment:** The threat of the department raising a claim of failure to exhaust administrative remedies is improper. The requirement to exhaust administrative remedies is pertinent only to refund claims and not to protests. The law does not provide for the argument of failure to exhaust administrative remedies outside of the claim for refund procedure. (*Loeb & Loeb LLP; Pillsbury, Madison & Sutro*, Comment 10)

**Comment:** There is no authority for the regulation's failure-to-exhaust-administrative-remedies proposition. There is no California appellate decision upholding an FTB assertion of that defense in connection with a "protest." Why were the authorities not cited in the notice or initial statement of reasons? This provision is an inappropriate threat. (*Richard E.V. Harris*, Attachment A, Item Nos. 74-77; *Richard Harris*, Transcript, pp. 41-42)

**Response:** The failure-to-exhaust reference was included in the regulation for purposes of providing notice to taxpayers of potential consequences. The department does not believe the language is superfluous just because it already has the right to make this assertion. Taxpayers have a need to know that the department might make the assertion. The proposed regulation does not require that it be asserted whenever there is a failure to supply information.

A protest can be converted to a claim for refund by the act of paying. It has been judicially recognized that the failure to reply to inquiries during the period a claim for refund is pending may give rise to a failure-to-exhaust defense on the part of a tax agency. This language is included in the protest regulation to place taxpayers on notice that the department may assert a failure-to-exhaust defense as the result of a taxpayer's failure to respond to requests for information in the protest setting, as well as the claim for refund setting.

The department agrees that the assertion of a failure-to-exhaust claim is only as effective as the facts upon which it is based. There is nothing in the language of the proposed regulation that makes it anything more than that. The proposed regulation does not, and could not, direct any reviewing authority as to the determination that they might make on the assertion of the defense.

The department agrees there are no California appellate (judicial) authorities addressing this question. One reason for that fact is that tax matters are generally only adjudicated through the filing of a claim for refund. That does not mean that failure to respond during a protest proceeding could not be used as an element of a pattern of conduct in support of a failure-to-exhaust claim. The proposed regulation puts taxpayers on notice of that possibility. The authority for this position is identical to that involving raising a failure-to-exhaust defense in the context of a claim for refund setting.

The department does not believe that raising the question of a failure-to-exhaust claim is improper. Taxpayers need to be advised of possible consequences of their actions. The department does not agree that the failure to exhaust is only pertinent for claims for refund. In both circumstances, the taxpayer has the

burden of establishing that the department's determination of their tax is incorrect.

**Recommendation:** No change is required.

**Comment:** The statutory prerequisite to judicial relief from an assessment of income or franchise tax is payment of tax and filing of a refund claim. The prior filing of a protest to the proposed assessment is not required. Failure to prosecute a protest should not create a bar since a protest is not required. (*Loeb & Loeb LLP*)

**Response:** The department agrees that the prerequisite to seeking judicial review of a tax matter is generally payment of the tax and filing a claim for refund. The filing of a claim for refund does not require a filing of a protest. In the circumstances where the taxpayer is filing a claim from an original return, the filing of a protest is not even possible. A failure-to-exhaust defense in the context of a protest does not create a jurisdictional bar to attempt to pursue either an administrative or judicial remedy. It may create a judicial or administrative bar if the adjudicative body believes it is appropriate. The regulation puts a taxpayer on notice that the department may attempt to assert the defense. It is unlikely this would happen unless there has been a pattern of failing to supply information that has been repeated throughout the process.

**Recommendation:** No change is required.

**Comment:** The use of the word "may" is confusing. The word "may" lacks clarity and authority and is misleading. The filing of a protest and a request for a hearing are optional with the taxpayer, and after six months the taxpayer can deem the protest denied and file an appeal with the State Board of Equalization. Because the taxpayer need not wait for the administrative process to be completed, it is inappropriate to assert a claim there has been a failure to exhaust. If the purpose of the language is to put the taxpayer on notice, then the words "perhaps will" or "might" should replace "may." If it is a warning, the section should include a statement that it is there for notice purposes. (*Richard E. V. Harris*, Item Nos. 63-73; *Richard Harris*, Transcript, pp. 41-49)

**Response:** The word "may" is not mandatory and indicates that a choice can be exercised. This is the intent of the language. The word "might" could be used, but it is not apparent that this would provide any greater clarity or authority.

The taxpayer does not have the right to deem a protest denied after six months and proceed with an appeal to the State Board of Equalization. That right only exists with respect to claims for refund. A taxpayer can, of course, pay the amount it is protesting and convert the protest to a claim for refund from which it can take a deemed denial position.

**Recommendation:** No change is required.

**Comment:** The regulation provides no guidance regarding the meaning of "failure to provide a timely and complete response" or regarding the basis on which a taxpayer can contest the FTB's determination that the taxpayer's response was not timely or was not complete. This is particularly troubling in light of the fact that it may result in questions of fact being resolved against the taxpayer. Already taxpayers often find it difficult to answer the innumerable requests for information that they receive in the course of a protest, particularly when the years at issue are old. This provision would penalize taxpayers unfairly for a situation that typically is out of their control. (*Morrison & Foerster, C.*, pp. 6-7, incorrectly referred to as (i)(3))

**Response:** The question of what is a failure to provide a "timely and complete response" is a question of fact to be determined on the basis of the unique circumstances of each protest. Subdivision (g)(2)(A) sets forth the basis upon which timeliness will be determined from the perspective of the department. The taxpayer, of course, can contest this.

The proposed regulation does not contain a statement that the taxpayer will be advised when, and to what extent, the taxpayer's response is not timely or complete. An addition of a statement to that effect appears to be appropriate.

Subsection (g)(3) advises the taxpayer of consequences that may arise if they fail to respond to inquiries. These are the current practices of the department. It does not require the department to invoke any of these provisions, but it does provide notice to taxpayers that they may be invoked. The discretion is not unfettered.

Any decision adverse to a taxpayer with respect to a protest may be appealed to the State Board of Equalization. Alternatively, a taxpayer may pay the tax assessed and file a claim for refund and proceed through the avenues of appeal offered by statute in that circumstance. Those are the avenues of appeal open to the taxpayer now, and no new rights or obligations are intended to be created.

**Recommendation:** It is recommended that a statement be added to the proposed regulation that the taxpayer will be advised that their response or failure to respond is not timely and the extent to which it is incomplete.

**Comment:** Who will decide whether there has been a failure to exhaust? (*Ernst & Young LLP*, p. 5)

**Response:** The department will make the determination as to whether to assert a defense, and the body to whom the defense is raised will determine whether it is applicable. In the circumstances set forth in the proposed regulation, that body is a third party, the State Board of Equalization or the courts. It would be presumptuous for the Franchise Tax Board to attempt to direct the standard to be applied by those parties. All it can do is argue for a standard of application.

**Recommendation:** No change is required.

**Comment:** What standard will the fact finder apply in making a determination?  
(*Ernst & Young LLP*, p. 5)

**Response:** The department does not have the power to create the standard. The standard exists in the current case authorities of the courts and the State Board of Equalization.

**Recommendation:** No change is required.

(h)(1)

**Comment:** The reference to a letter of determination should be clarified. It would be helpful if the term is defined. Finally, there is no sound reason for limiting the issuance of a letter of determination to the situation when a hearing has been requested. A letter of determination should be required in all instances.  
(*Pillsbury, Madison & Sutro*, Comment 11)

**Response:** A Notice of Action on a taxpayer's protest is required in all cases. It is the Notice of Action that starts the period in which an appeal may be taken to Board of Equalization. There is nothing in the statute that requires more than the issuance of a Notice of Action.

The letter of determination is not intended to be a formal document. It has no formal significance, and therefore a definition is not needed. The letter of determination is a means by which the decision of the department and its rationale is communicated to the taxpayer. Where such a letter has been written and it provides a more complete explanation than is typically supplied in a formal Notice of Action, it is appropriate to allow incorporation into the Notice of Action by reference.

The regulation requires a letter of determination in cases where a hearing has been requested. It does not prohibit a letter of determination in cases where a hearing has not been requested. The staff believes it is appropriate to provide a more direct response in cases where a hearing has been requested because the request for a hearing suggests that the taxpayer desires something more than just a review of the item and a determination. The request for a hearing suggests the desire to discuss the adjustment, and, therefore, providing a written response unless it has been waived is appropriate.

**Recommendation:** No change is required.

(h)(2)

**Comment:** There is no basis for asserting that the "date of mailing" is presumed to be the date on the Notice of Action. This section suffers from all the infirmities that plague section 19041(b). (*Cal-Tax*, p. 4, Section 19041(h), Determination on Protest; *Richard E. V. Harris*, Attachment A, Nos. 79-81; *Dave Doerr*, Transcript, p. 87)

**Comment:** The context of a Notice of Action is different from the context presented by a Notice of Proposed Assessment. A protest is an administrative appeal to the FTB, and the FTB can bind itself. The timeliness of an appeal is not a question for the FTB to decide, but one for the Board of Equalization. The FTB cannot bind the Board of Equalization. It is the Board of Equalization that is the administrative tribunal that decides whether an appeal is timely. This portion should be deleted or contain only a statement that the FTB will not assert that a Notice of Action issued by it was mailed to the taxpayer on any date earlier than the date set forth on the notice. (*Richard E. V. Harris*, Attachment A, Item Nos. 82-87, *Richard Harris*, Transcript, pp. 45-49)

**Comment:** The regulation should not create a presumption that the date on the Notice of Action is the date of mailing. The date on the Notice of Action is neither the date of preparation nor the date of mailing. The date of the mailing of Notice of Action is determinative of when an appeal must be filed with the State Board of Equalization. The FTB cannot establish a presumption with respect to a date that establishes the State Board of Equalization's jurisdiction over a case. (*Richard E. V. Harris*, pp. 72-87)

**Response:** The proposed regulation advises taxpayers of the position of the Franchise Tax Board that the date of a Notice of Action will be presumed to be the date of mailing. The Franchise Tax Board does not have the power to bind the Board of Equalization with regard to the date of the mailing of the Notice of Action. The taxpayer is free to attempt to rebut the presumption by any means it chooses. The postmark on the envelope would appear to be the easiest.

**Recommendation:** Change the proposed regulation to indicate that the department will treat the date on the Notice as the date of mailing for purposes of determining the timeliness of an appeal. Include language that the taxpayer has the opportunity to submit evidence in support of a different date including the postmark on an envelope.

## **Proposed Regulation 19044**

### **General**

**Comment:** The proposed regulation discusses an oral hearing in a protest as being a right that the taxpayer can lose by not requesting it in the original protest. However, this discussion is misleading and inequitable as discussed above. [It is misleading and inequitable for the regulations do not explain to taxpayers that the protest is exempted from the Administrative Procedure Act. [The protest process] violates a taxpayer's constitutional right to due process, violates California law, and goes against common sense. [*Paraphrasing and condensation of comments regarding proposed regulation 19041*] (*Riordan & McKinzie*, p. 2)]

**Response:** The statute provides the taxpayer with the right to a hearing if it is requested in the protest. The protest itself is a time sensitive document. Read together, the two statutes require that a hearing be requested in the protest or the right to a hearing is waived. The proposed regulation does not set forth the statutory exemption to the Administrative Procedure Act. This is not readily apparent in the Revenue and Taxation Code.

**Recommendation:** Add language noting the exemption of protest hearings from the Administrative Procedure Act.

**Comment:** The regulation should be revised to include a statement regarding taxpayer rights generally. For example, a statement regarding reasonable, fair and impartial should be included. (*Richard E.V. Harris*, Item Nos. 89-90)

**Response:** The subject matter of the proposed regulation is protest hearings. It is not the conduct of the employees of the Franchise Tax Board. The department agrees that all matters should be handled in the manner described, but this proposed regulation is not the appropriate place to include such rules.

**Recommendation:** No change is required.

**Comment:** How many protest hearings does the FTB conduct annually? What numbers and cumulative records are maintained regarding protest hearings? What was the approximate range of length of the protest hearings held during the last several years? (*Richard E.V. Harris*, Supplement B, Item Nos. 92-95)

**Response:** Protests are broken into two categories, docketed and undocketed. The differentiation is that docketed protests are handled by the Legal Branch and undocketed protests are handled by the Audit Branch.

The Legal Branch maintains the records on docketed protests. These records reflect the number of hearings held during a period of time. For the year 1999 there were 30 hearings and for the year 1998, 26 hearings. The Legal Branch's records do not indicate if multiple hearings were held with respect to a protest or the length of time for hearings. It is estimated based on anecdotal information that the typical protest hearing on a docketed case would encompass three or four hours. Some hearings might be as short as an hour and some might encompass a full day.

The Audit Branch maintains the records with respect to undocketed protests. Separate records are not maintained on the number of hearings held during a year. A record is maintained on the number of protests received that requested a hearing. In some cases a taxpayer determines a hearing is not necessary and in other cases a hearing is held even though not requested. Staff believes that these two events occur in approximately equal numbers and therefore the number of cases in which a hearing is requested approximates the number of cases in which a hearing is held. For the fiscal year 1999, there were a total of 430 cases in which a hearing was requested. For the fiscal year 1998, the number was 569. No specific records are maintained with respect to the length of hearings. For planning purposes the Audit Division assumes a hearing involving a Personal Income Tax case will take approximately one hour and that a hearing involving an apportioning corporation will take approximately two hours. The length of time planned for any individual case is usually reached by agreement of the hearing officer and the taxpayer or the taxpayer's representative.

**Recommendation:** No action is required.

## Necessity

**Comment:** As for "necessity," the Office of Administrative Law ruling does not establish "necessity" for the particular contents of the proposed regulation, even though some type of regulation might be necessary. (Re: AOL ruling regarding the classification of an FTB form as an underground regulation. (*Richard E. V. Harris*, p. 1)

**Response:** The ruling by the Office of Administrative Law (OAL) that then-existing forms constituted "underground regulations" does establish a need for regulations to the extent it is appropriate to have any rules, procedures or practices that the OAL ruling found to be improper. The fact that other rules or procedures may also be promulgated of a nature similar to those found to be improper in the OAL ruling establishes that those rules or procedures must also be adopted by regulation or they will be subject to attack as "underground regulations."

**Recommendation:** The OAL ruling does establish the need for a regulation regardless of the content of the rules to be adopted. The statement of reasons will, nonetheless, contain an expanded statement of necessity.

## Due Process

**Comment:** The proposed regulation results in a hearing process that it is controlled almost entirely by the FTB and in which the taxpayer has virtually no rights. The FTB appears to have nearly total discretion when, where, how and even whether a hearing will be held. FTB, but not the taxpayer, can stop the recording of a hearing which can plainly lead to a misleading record. Exercising discretion in a taxpayer's favor provides little consolation because of the absence of any explicit assurance that the FTB will exercise its discretion liberally in the taxpayer's favor. Tilting the balance regarding oral hearings so far in the FTB's favor runs contrary to the objective of getting all issues on the table and resolving as much of the case as possible before it proceeds to an appeal. These restrictions on a taxpayer's right to an oral hearing appear to be unauthorized by statute. They may well violate due process. (*Morrison & Foerster*, II., p. 8)

**Response:** The regulation reflects the fact that a hearing will be held during normal business hours. The taxpayer, as provided by statute, is entitled to a hearing in the district office convenient to them. If they do not provide adequate notice of inability to attend a hearing, it may be scheduled in Sacramento. The regulation describes the manner in which the hearing will be conducted. This is intended for informational purposes. The informality of the process was intended to be preserved while providing the taxpayer with guaranteed rights. The question of whether a hearing will be granted is initially in the taxpayer's control. The statute gives the taxpayer a right to a hearing if requested in the original protest. The right to a hearing after the initial protest is at the department's discretion. Hearings are conducted in an informal setting and manner. There is normally no recording of a hearing. The purpose of a recording is unclear since the hearing is not designed or conducted in a manner to establish an administrative record. Subsequent proceedings are conducted without reference to the hearing other than the fact that one was held and that a determination was made by the hearing officer. Testimony is not taken in a manner that qualifies it for submission to a court or the Board of Equalization. Documentary evidence is not received under the formalities required in a judicial setting.

There is no violation of due process.

**Recommendation:** No change required.

(b)

**Comment:** It is unclear what rationale exists for denying taxpayers oral hearings unless requested in the original protest. The circumstances necessitating such a hearing may not arise until after the initial protest is filed. (*Cal-Tax*, p. 4, Regulation Section 19044(b), Request for Hearing; *Dave Doerr*, Transcript, p. 87)



**Response:** The statute requires that an oral hearing be granted if a request is included in the protest. The protest is a time-sensitive document. The proposed regulation reflects the statutes. The proposed regulation allows a hearing to be granted even if not requested in the protest.

**Recommendation:** No change is required.

**(b)(1)**

**Comment:** This section is burdensome for the taxpayer. The taxpayer or the taxpayer's representative should be allowed to amend their protest to request an oral hearing. (*Arthur Andersen LLP*, p. 9)

**Response:** The statute allows a taxpayer an oral hearing "if the taxpayer has so requested in his or her protest. . . ." The proposed regulation follows the statutory framework. Subsection (b)(2) provides that the FTB may allow an oral hearing if a request is made subsequent to the filing of the original protest. The department intends to be liberal in granting such requests and will grant them if the department requests additional information and the request is made prior to the date for submission of the information

**Recommendation:** No change is required.

**(b)(3)**

**Comment:** A taxpayer should not be limited to only one hearing. Often there is no need for more than one hearing, but there are many instances in which the fair administration of the law requires more than one hearing.

Example 1, the hearing officer is well prepared for the hearing and has eight follow-up questions related to the protest.

Example 2, the hearing officer is unprepared for all the issues raised in the protest.

These are several examples where an additional hearing would be appropriate. The proposed regulation should contain examples of where more than one hearing will be allowed. (*Ernst & Young LLP*, p. 2; *Eric Coffill, Morrison & Foerster*, Transcript, pp. 98-99)

**Comment:** Taxpayers should be entitled to two (2) hearings. In most circumstances a single hearing will be all that is necessary; however, in those instances in which the first hearing raises additional issues for consideration that the taxpayer wishes to address, the taxpayer should be allowed the second hearing without needing the FTB's acquiescence. Any subsequent hearing can be at the FTB's discretion. (*Cal-Tax*, p. 4, Regulation Section 19044(b), Request for Hearing; *Dave Doerr*, Transcript, pp. 87-88)

**Response:** The statute provides for a hearing, not multiple hearings. The regulation follows the statute by stating that a single hearing is allowed. This does not prohibit the department from having more than one hearing but the statute does not require it to do so. The proposed regulation recognizes that additional oral hearings may be necessary. The department agrees that a second hearing, or more, should be granted, if necessary. The examples provided by the representative are circumstances where one would expect a second hearing to be granted. The practice of individual hearing officers varies but in most cases the hearing officer will ask questions prior to scheduling a hearing. Some hearing officers schedule hearings immediately to discuss the case with the taxpayer and determine how to proceed. In those circumstances, it would be expected that a second hearing would be held if necessary.

Circumstances do arise where requests for hearings and the submission of additional information or arguments are subterfuges for delaying action on the case. There should be a basis for limiting the number of hearings in that circumstance.

**Recommendation:** Amend the proposed language to indicate that more than one hearing will be held if appropriate and move the language concerning department discretion.

**Comment:** The section should allow more flexibility to account for complex cases. There needs to be an acceptable procedure to extend the time period past the 33 months when there is a complex corporate case involved that is moving satisfactorily. The procedure to deal with complex corporate cases differs from simple corporate cases or personal income tax cases, which the 33-month rule has enough flexibility to handle. If the FTB does not feel the complex corporate case is moving satisfactorily, the regulation should be drafted to give them the right to issue a warning to the taxpayer that the 33-month rule will be invoked or that a protest hearing will be scheduled if there is undue delay of information. (*Arthur Andersen LLP*, p. 9; *Arthur Andersen*, Transcript, p. 72-73)

**Response:** The proposed regulation does not contain any reference to a period of time when a protest needs to be completed. FTB Notice 99-1 informs the public that staff is operating under guidelines intended to complete a case within 33 months, but there is no requirement that it be done. The regulation is flexible. It sets forth various periods of time that a taxpayer can rely upon and indicates that those time periods can be extended. The proposed regulation does not restrict the department's ability to move a case along if it is not moving satisfactorily.

**Recommendation:** No change is required.

(c)

**Comment:** This subsection is too vague regarding the right of the taxpayer to have the hearing location convenient to the taxpayer. We have been faced with many occasions where the protest officer has not wanted to hold hearings at locations outside of California and has not provided a satisfactory reason for refusing to do so. Section 21011 of the Revenue and Taxation Code states that a hearing shall be held in an FTB office convenient to the taxpayer whenever possible. The regulation should clearly so state or that other arrangements such as via telephone or videoconferencing are acceptable. FTB should have to have clear justification for not going to a field office convenient for the taxpayer. The wiggly words should be removed from the [proposed] regulation text. (*Deloitte & Touche*, Transcript, pp. 55-56)

**Response:** The language of the proposed regulation virtually tracks the language of Section 21011 of the Revenue and Taxation Code. The language regarding alternative means of holding hearings can be modified to place it at the taxpayer's option. The proposed regulation makes the statement in two sentences. The first sentence says the taxpayer can make a request for a hearing at an office that is convenient to them. The second sentence says the department shall grant such request when possible. The FTB cannot know what is convenient to the taxpayer if they do not make a request. Subsection (3) of this subsection provides that a hearing may be conducted by telephone, videoconferencing or similar means if the taxpayer consents. The taxpayer is entitled to an oral hearing by statute. The taxpayer must consent to a hearing of a different nature. The proposed regulation is clear.

**Recommendation:** Revise the language regarding alternative means of hearings to make it clear that the taxpayer may so request.

(c)(1)

**Comment:** Listing acceptable locations on the internet would make the information more accessible. (*Arthur Andersen LLP*, p. 9)

**Response:** The department agrees with this statement but there is no need to include it in the proposed regulation.

**Recommendation:** No change is required.

(c)(2)

**Comment:** The section should be revised to provide that a hearing at the taxpayer's option may be held via telephone, video conferencing, etc. In its current form the proposed regulation merely provides that the taxpayer give "consent" to such a hearing. Thus, in its current form, it is the FTB that determines whether a teleconference takes place. With our modern means of

communicating, there is no reason for the regulation to give such discretion to the FTB. Taxpayers should control how the hearing will take place, in person, via teleconferencing etc. (*Cal-Tax*, p. 4, Regulation Section 19044(b), Request for Hearing [Sic]; *Dave Doerr*, Transcript, p. 88)

**Response:** It is the taxpayer who has the right to the oral hearing. It is the taxpayer who most consent to holding a hearing by teleconference. The department has no objection to such hearings.

**Recommendation:** Amend the proposed regulation to indicate that an oral hearing will be conducted by other means if requested by or consented to by the taxpayer.

**Comment:** What happens if the taxpayer or the taxpayer's representative does not consent to the holding of the oral hearing via telephone or videoconference? (*Arthur Andersen LLP*, p. 10)

**Response:** The oral hearing will be conducted in person.

**Recommendation:** No change is required.

(d)

**Comment:** The potential for abuse should be apparent. The lack of a meaningful requirement that the FTB take action on a protest can result in the taxpayer being at the mercy of the FTB's willingness to resolve their dispute. (*Cal-Tax*, p.5, Section 19044(d), Time)

**Response:** The FTB has no interest in delaying action on a protest other than an interest in attempting to resolve it on a fully informed basis. The legislature has imposed no requirement on the FTB to act upon a protest in a specific period of time. Even the Taxpayer Bill of Rights does not have such a requirement. The taxpayer can always pay the tax involved and thereby convert a protest into a claim for refund. After the protest has been converted, the taxpayer can deem what is now a claim denied after six months.

**Recommendation:** No change is required.

(d)(3)

**Comment:** The Taxpayer Bill of Rights requires that hearings be held within a reasonable time that is "convenient to the taxpayer when possible." (See R&T Code Section 21011) Nothing in this section attempts to accommodate taxpayers. Why should taxpayers be required to take a day off simply to be afforded basic due process? Hearings should be scheduled to accommodate the

taxpayer, including allowing for evenings and Saturdays. (*Cal-Tax*, p.5, Section 19044(d), Time; *Dave Doerr*, Transcript, p. 88-89)

**Response:** There is no denial of due process in requiring that hearings be scheduled during normal working hours and on normal working days. Both the Board of Equalization and the courts operate in that manner. The phrase "convenient to the taxpayer when possible" refers to the physical location of the hearing, not the time. Time is subject to the requirement of "reasonable." Normal business hours meet this requirement.

**Recommendation:** No change is required.

**(d)(4)**

**Comment:** It would seem appropriate that the reference to the term "one week" should be clarified. Does it mean 5 business days or 7 calendar days or what? (*Pillsbury, Madison & Sutro*, Comment 12)

**Response:** The term "one week" is generally understood to encompass a period of seven days. If the intent was business days, then it would be appropriate to state it in that manner. If it is not described as business days, then the normal usage would control. The general rule is that if the seventh day falls on a holiday or a Saturday or Sunday, the next business day applies, but it does not appear to be necessary to state it. If the proposed regulation were to be modified to describe a week as 5 business days, would there then be a need to define the 60-day period as encompassing calendar days or business days?

**Recommendation:** No change is required.

**Comment:** It would seem appropriate to note that if a request is made at whatever late date is agreed upon, that the request be sent to the FTB by fax. (*Pillsbury Madison & Sutro*, Comment 12)

**Response:** The regulation is silent as to the means of transmittal. A fax or e-mail would constitute a writing for purposes of the regulation, and, in fact, would be preferable to a letter, which is subject to the vagaries of the postal system and internal processing.

**Recommendation:** Amend the language to include the word "sent."

**(d)(5)**

**Comment:** The rescheduling of a hearing at the discretion of the hearing officer should be modified to provide some standards for the exercise of discretion, as well as inclusion of a good or reasonable cause exception. (*Pillsbury Madison & Sutro*, Comment 12)

**Response:** Discretion is only exercised in the event the request for rescheduling does not occur one week prior to the hearing. The rescheduling is permissive. A good or reasonable cause exception can be added. The intent is to avoid last minute cancellations that delay completion of the protest not to establish rules to close protests because of failure to appear at a hearing.

**Recommendation:** Add a good cause exception.

**Comment:** In the second sentence, the "received by" should be changed to "sent to." The taxpayer should not bear the burden of ensuring that the FTB mail system delivers the mail to the appropriate person by the required time. (*Arthur Andersen LLP*, p. 11)

**Response:** "Received by" provides notice to the department and allows for the opportunity to reschedule. "Sent by" may not be received on a timely basis. A taxpayer, however, that uses the mails will not have knowledge as to when something is received. The comment is appropriate.

**Recommendation:** Amend the proposed regulation accordingly.

#### (d)(4) & (5)

**Comment:** Since unforeseen events take place (outside of "good cause") a taxpayer should be allowed, at his or her option and not at the FTB's discretion, to reschedule a hearing with less than a one week notice. Subsequent rescheduling can be at the discretion of the FTB. (*Cal-Tax*, (d), p. 5, Section 19044(d), Time; *Dave Doerr*, Transcript, p. 89)

**Response:** There is a need for a rule. Court dates and things of that nature are normally fixed. The date of a hearing on a protest should also be relatively fixed. This does not mean that attempts to reschedule a hearing on shorter notice should not be, and will not be, allowed.

**Recommendation:** No change is required.

#### (d)(5)

**Comment:** The word "week" is not defined in the regulation. (*Spidell Publishing, Inc.*, p. 2 and 5 Attachment 19044)

**Response:** The word "week" has a common meaning of seven calendar days. There is no need to define it as a "calendar week." In most circumstances, a week will normally encompass the same period as a calendar week. The exception arises if there is a holiday. Inserting a definition of the word week

would then also necessitate the assertion of a definition of "days" in other portions of these two regulations and other regulations.

**Recommendation:** No change is required.

**(f)(1)**

**Comment:** The FTB should be required to give notice (at least one month) to the taxpayer or the taxpayer's representative if the hearing officer is changed. In complex corporate cases every effort should be made to avoid changes. (*Arthur Andersen LLP*, p. 12)

**Response:** The reason for this request is unclear. The identity of the hearing officer does not appear to be significant to the taxpayer and in most circumstances the name of the hearing officer will probably be irrelevant. The principal concern of the taxpayer should be with having a hearing officer who is familiar with the file and the issues in the protest. A newly-assigned hearing officer will have access to any files the department has collected regarding the protest. The department needs to preserve its flexibility with respect to its employees and their assignments.

**Recommendation:** No change is required.

**(h)**

**Comment:** The FTB should add a commitment that it will schedule and conduct all oral hearings in a reasonable, fair and impartial manner. (*Richard E. V. Harris*, Supplement B, Item 91)

**Response:** The department believes it does conduct hearings in a reasonable, fair and impartial manner and deals with all protests in that manner. Adding such a statement would be superfluous. Also adding language such as that merely provides a basis for disputes where none is appropriate. Complaints about the hearing process and the conduct of the hearing officer should be dealt with otherwise and are in the nature of employee discipline matters.

**Recommendation:** No change is required.

**(h)(2)**

**Comment:** Section 19044 was amended in 1999 to require the Franchise Tax Board to include on the Notice of Action a specification of the date determined by the Franchise Tax Board to be the last date for filing an appeal. (*Staff*)

**Response:** Not applicable.

**Recommendation:** The proposed regulation should be amended to reflect the changes in the statute.

**(h)(4)**

**Comment:** The hearing officer should not be vested with the authority to limit the number of representatives a taxpayer desires to have present at a hearing. So long as the representatives handle themselves in a manner in which the hearing officer controls the hearing, a taxpayer should have the ability to determine the number of representatives he or she desires. (*Cal-Tax*, p. 5, Section 19044(h)(4), Conduct of Hearing; *Dave Doerr*, Transcript, p. 89)

**Response:** The proposed regulation allows the taxpayer to designate multiple persons to represent them at the hearing. The hearing officer can limit the number, but the first sentence of the proposed regulation clearly contemplates more than a single representative. The proposed regulation strongly suggests that the hearing officer should allow multiple representatives. The limiting language is proposed to address potential abuses without specifying a number.

**Recommendation:** Rephrase the language to indicate that more than one representative will be allowed unless to do so would be disruptive.

**Comment:** Some cases involve detailed and complex issues. Sometimes the taxpayer is best represented by having subject matter experts who have specific expertise in a given area of the tax law addressing certain issues. Sometimes more than one area is implicated. Therefore it may be appropriate to have three or four different representatives at the hearing to address different subject areas. The problem is there is no delineation of when the hearing officer might limit attendance at the hearing. Either the rule limiting a taxpayer to one representative should be deleted or rules should be put into place to address the question of representation prior to the hearing. (*Ernst & Young LLP*, p. 3)

**Response:** The hearing officer is authorized to allow more than one active representative where in his judgment this does not cause a disruption of the hearing. In the example presented where a different representative will address different issues, it is unlikely that a disruption will occur and more than one representative should be allowed to speak by the hearing officer.

**Recommendation:** No change is required.

**Comment:** This is too restrictive. At least two active representatives should be allowed. (*Arthur Andersen LLP*, p. 13; *Arthur Andersen*, Transcript, pp. 73-74)



**Response:** The proposed section contemplates multiple representatives and allows for more than one representative, unless to do so would be disruptive.

**Recommendation:** No change is required.

**(h)(5)(B)**

**Comment:** Written consent for others to attend a hearing should not be required in every case. (*Staff*)

**Response:** Not applicable.

**Recommendation:** Make written consent optional.

**(h)(6)**

**Comment:** This particular subdivision is unclear. The last sentence, which speaks to the subsequent proceeding being on a *de novo* basis, should be defined or deleted. Quite obviously, taxpayers are able to present the evidence, which has been presented to the Franchise Tax Board during a protest proceeding, at the State Board of Equalization or in court. The normal practice is to present all evidence which has been presented below at the appeal to the State Board of Equalization. This subdivision should not change this practice. (*Pillsbury, Madison & Sutro*, Comment 13)

**Response:** The protest proceedings are informal in nature. Evidentiary rules are not relied upon and statements are not required to be given under oath. The protest hearing does not establish an evidentiary record that is automatically transmitted to the Board of Equalization or the courts. Both parties have the duty to make their offers of evidence at the higher level. The intent of this subsection is to ensure that taxpayers are aware of this fact. This subsection provides no limitation on the material that can be presented into evidence in subsequent proceedings. It advises taxpayers that material presented at the protest level is not automatically admitted or transferred to another level. This subdivision makes no change in existing practice; it states what existing practice, in fact, is.

Many taxpayers may not be aware of the meaning of the term *de novo*. This term should be replaced with a statement of what it means.

**Recommendation:** Replace the term *de novo* with a description of what is meant.

**(h)(7)**

**Comment:** It should be made clear that a taxpayer is able to bring a court reporter to a protest hearing to record the hearing and any testimony which is

given. This is the current practice of the Franchise Tax Board and should not be changed. (*Pillsbury, Madison & Sutro*, Comment 14)

**Response:** It is not the practice of the Franchise Tax Board to have a court reporter at a protest hearing. The department is unaware of anyone having made this request. If a request was made to have a court reporter attend a hearing, it might be allowed, but it is not clear what the purpose of the reporter would be. Protest hearings are informal in nature. No record is made for use in subsequent proceedings. Oaths are not administered and evidentiary rules are not enforced. The recording of a protest hearing by a court reporter would normally not cause it to have any evidentiary weight. It would seem unlikely it would be accepted into evidence by the Board of Equalization or a court.

**Recommendation:** No change is required.

#### (h)(7)(A) & (B)

**Comment:** The word "week" is not defined in the regulation. (*Spidell Publishing, Inc.*, p. 2 and 5, Attachment 19044)

**Response:** The word "week" has a common meaning of seven calendar days. There is no need to define it as a "calendar week." In most circumstances, a week will normally encompass the same period as a calendar week. The exception arises if there is a holiday. Inserting a definition of the word week would then also necessitate the insertion of a definition of "days" in other portions of these two regulations and other regulations.

**Recommendation:** No change is required.

**Comment:** The hearing officer's consent to recording should not be required. Recording should be allowed unless it is disruptive. (*Staff*)

**Response:** Not applicable.

**Recommendation:** Strike the requirement of hearing officer's consent.

#### (h)(8)(A)

**Comment:** The requirement that a taxpayer inform the hearing officer of the names and identities of witnesses who will be present at the hearing at least one week prior to the hearing should be deleted. There is no such requirement in formal court proceedings and none should be provided for in an informal protest proceeding. (*Pillsbury, Madison & Sutro*, Comment 15)

**Response:** The department agrees that this should not be a mandatory requirement. Advising the hearing officer of individuals who will appear at the

hearing may be conducive to a more productive hearing but it should not be a requirement.

**Recommendation:** Amend the proposed regulation to suggest a list of witnesses should be provided.

**Comment:** The regulation should be revised to note that the parties should have the ability to record testimony under oath so that it can be used in future administrative proceedings, such as appeals before the State Board of Equalization. (*Pillsbury, Madison & Sutro*, Comment 15)

**Response:** Franchise Tax Board employees have the power to take testimony and to administer oaths, Section 19504(b) Revenue and Taxation Code. This is not a power the Franchise Tax Board has exercised in conjunction with protest hearings. Requiring testimony to be given under oath is inconsistent with the informal nature of protest hearings. The parties have always been required to submit directly to the Board of Equalization matters which they wish to have considered by that body.

**Recommendation:** No change is required.

#### (h)(8)(A)1

**Comment:** What does "previously identified" mean? Does it mean at least one week before the hearing? Can the taxpayer inform the hearing officer by telephone? (*Arthur Andersen*, p. 15)

**Response:** In the context of this subsection, "previously identified" refers back to the information provided to the hearing officer at least one week prior the hearing. There is no limitation on the means by which this information is provided. A written record may make it easier to prove that information was provided, but telephonic notification is acceptable. Removing the requirement of prior notification obviates the need for the sentence.

**Recommendation:** Delete the sentence.

#### (h)(8)(A)3

**Comment:** Does the FTB have the authority to issue subpoenas for a protest hearing to compel anyone to attend a hearing? Has the FTB ever exercised that authority? (*Richard E. V. Harris*, Supplement B Item 96)

**Response:** Yes, Section 19504(c) is the authority for the issuing of subpoenas. The hearing officer is unaware of that authority having been exercised.

**Recommendation:** No change is required.

**Comment:** Subsection (8)(3) [sic] provides that the department shall not issue subpoenas on behalf of taxpayer to compel witnesses to appear, which is fine, except that the taxpayer should be entitled to have the auditor or such other FTB personnel available for testimony as may be relevant to their protest. (*Cal-Tax*, p. 5, Section 19044(h), Conduct of Hearing; *Dave Doerr*, Transcript, pp. 89-90)

**Response:** The hearing is an informal process. Protest hearings are not a trial between the taxpayer and the auditor. Formal testimony is not received.

**Recommendation:** No change is required.

#### (h)(8)(B)2

**Comment:** The ability to submit material is not limited to the department and the acceptance of the material is not a matter the department can rule upon. (*Staff*)

**Response:** Not applicable.

**Recommendation:** Make appropriate changes.

#### (h)(9)

**Comment:** Requests for additional information should be made prior to the conclusion of the hearing. (*Spidell Publishing Inc.*, p.6, Attachment, 19044)

**Response:** Requests for additional information may arise during the course of the hearing and can and should be made at that time. As a hearing proceeds, however, it may become clear that information requested is not needed. Providing for a summary of the information requested prior to the conclusion of the hearing is intended to eliminate confusion. Requests for information should also be made in writing so there is a record of the request for both the taxpayer and the department and confusion as to what has been requested can be minimized.

**Recommendation:** No change is required.

**Comment:** The department may request additional information and the taxpayer can be penalized for not providing it in a timely or complete manner. See comments on proposed regulation 19041(g). (*Morrison & Foerster*, II., p. 8)

**Response:** This section is intended to make clear that the department may make a request for additional information regarding the protest so that it may make its determination based upon a review of all information that the department believes is relevant. Taxpayers who desire a full and complete consideration of their protest have a duty to respond. The proposed regulation

states the time for response will be provided to the taxpayer. The consequences of a failure to respond are set forth. The consequences are not penalties; they are a statement of the possible results of failures to respond.

**Recommendation:** No change is required.

**Comment:** The ability to request information allows the FTB staff to go on a fishing expedition for the information the hearing officer deems "necessary." There is no germane, relevance, or reasonable requirements on the FTB. (*Cal-Tax*, p. 5 Section 19044(h), Conduct of Hearing; *Dave Doerr*, Transcript, p. 90)

**Response:** The proceedings are informal. The purpose of the hearing, or any request for information, is to gather information to aid in the determination of the protest. Inherent in the process is a requirement that the information requested relate to the determination of the protest. No standard was included so there would not be a series of disputes arising from the question of whether the request was reasonable, germane or any other standard. If a taxpayer believes the requests are inappropriate, the taxpayer can refuse to supply the information. Whether such a refusal is appropriate can be determined by a third party in subsequent proceedings.

**Recommendation:** No change is required.

**Comment:** There is no authority in the statute which allows the Franchise Tax Board to determine a protest based upon a failure to submit information or to raise a failure to exhaust administrative remedies defense. (*Cal-Tax*, p. 5, Section 19044(h), Conduct of Hearing; see also p.1, ¶ 2)

**Response:** The proposed regulation does not create the authority to determine a protest in a manner adverse to the taxpayer based upon an assumption that any information which has not been submitted will be adverse to the taxpayer or to assert the failure to exhaust defense in subsequent proceedings. Such authority already exists from the presumption of correctness which attaches to a tax agency's audit determinations and the fact that taxpayers have the burden of establishing that the tax agency's determination is in error. This burden arises from the fact that it is the taxpayer that has possession of the books and records and other information that can establish the correctness or incorrectness of the tax agency's determination.

The proposed regulation does not say that these will be the results. It says these may be the consequences of these actions or decisions and provides notice to the taxpayers. It will be the decision of the Board of Equalization or the courts as to whether it is appropriate to resolve an issue against the taxpayer on the basis of failure to supply information or whether a claim of failure to exhaust administrative remedies is valid. The proposed regulation provides no further authority for the defense other than one of notice to the taxpayer.

See the following comment regarding resolution of the protest as an appropriate action by the department.

**Recommendation:** No change is required.

**Comment:** The department's only reaction to a taxpayer's failure to respond should be as stated in the first sentence of subsection (g)(3), viz., a resolution of the questioned facts against the taxpayer and a denial of the protest. There should be no implication that a taxpayer who has met this fate cannot thereafter acquire access to the courts by filing a claim for refund and providing all information requested by the department with respect to the claim. (*Loeb & Loeb*)

**Comment:** The statement that the department "may" assert a failure to exhaust administrative remedies defense is ambiguous. Is it only a warning? If a protest hearing is an option, how can the department assert a failure to exhaust a claim for a right that a taxpayer doesn't even have to pursue? The comments and observations regarding 19041 are incorporated here by reference. (*Richard E. V. Harris*, Item Nos. 98-100; *Loeb & Loeb LLP*)

**Response:** The statement was intended to put taxpayers on notice that this could occur. The assertion of the defense could be objected to by the taxpayer and would ultimately be ruled upon by the adjudicative body. This assertion would only arise if the taxpayer chose to pursue a right and then refused to accept the consequences of the exercise of that right.

**Recommendation:** No change is required.

**Comment:** This section should have the same timelines as 19041(g). (*Arthur Andersen LLP*, p. 15)

**Response:** The requests for information to which this subsection relates arise in the context of an oral hearing. The timelines provided for in proposed regulation 19041(g) can arise in correspondence as well as in the context of a hearing. Time periods of other than 30 days can be reached by agreement of the parties. A mandatory extension could be included in this section but normally should not be necessary.

**Recommendation:** Language allowing for a request for an extension and an automatic extension should be included.

## (h)(10)

**Comment:** Attempting to raise new issues should not be grounds for terminating a hearing. It is often in the best interest of fair administration to allow new grounds to be raised. If the ultimate resolution of the issue based on the

new grounds will result in a reduction of the amount due (or a complete cancellation of the amount due), it seems in the best interest of all to allow the grounds to be considered. (*Ernst & Young LLP*)

**Response:** The decision to terminate a hearing is within the discretion of the hearing officer. Raising a new ground does not require a hearing officer to terminate a hearing but it does allow the hearing officer to do so. In most circumstances, it is unlikely that this power will be used.

**Recommendation:** No change is required.

#### (h)(11)

**Comment:** Why doesn't the taxpayer receive a copy of the protest hearing report issued by the FTB? There ought to be a definitive timeline where a protest hearing report would be issued 60 days after the hearing if no additional information were to be provided. (*Arthur Andersen LLP*, p. 16)

**Comment:** Taxpayers should have the right to any hearing report or recommendation by a hearing officer whether prepared for internal use or otherwise. (*Cal-Tax*, p. 5; *Dave Doerr*, Transcript, p. 90)

**Response:** Protest hearing reports are prepared for internal purposes only. They are not prepared as an official statement to the taxpayer as to the determination of the taxpayer's protest. They have no official status.

There is nothing in the statute regarding protests that gives the taxpayer a right to receive a report on a hearing. The taxpayer has the right to receive a notice reflecting the determination of the protest. See Section 19045 of the Revenue and Taxation Code.

If a hearing officer is an attorney, the department believes that the hearing officer's report constitutes attorney work product and attorney-client communications and, therefore, is not discoverable. The department also believes that both the attorney hearing officer and the audit hearing officer reports are subject to the deliberative process exception to discovery as well.

In the circumstances where a hearing has been held, the proposed regulation provides that the taxpayer will receive a letter with the hearing officer's recommendation.

**Recommendation:** No change is required.

#### (h)(12)

**Comment:** The proposed language does not provide a definition of the phrase "reasonable period of time" with respect to either the notification of the taxpayer

of the recommendation of the hearing officer, or a reasonable period of time for a taxpayer to file a response to the notification. It is not clear how the Board will determine, and how taxpayers will know, what a reasonable time is. The use of the undefined phrase "reasonable period of time" will create uncertainties and unnecessary costs on regulated parties. Affected parties consist of both individuals filing under the personal income tax, and corporations filing under the corporate income tax. Since the term "reasonable period of time" is not defined, it is not clear if the same criteria will apply to both groups of taxpayers, and if the criteria will be equitable to all affected parties. For example, the individual tax protest may only require a few months to complete, while a corporate tax case may require several years. Therefore, a "reasonable period of time" for one taxpayer group may not be a reasonable period of time for another. The Board should consider establishing specific time frames or, at a minimum, guidelines regarding the likely response times. Such information would allow affected parties to clearly know their rights, as well as the responsibilities of the Board.

The failure to define the phrase "reasonable period of time" may also result in an adverse economic impact on a taxpayer who wants to respond to the recommendation of the hearing officer. Board staff have told RRU that, following the recommendation of the hearing officer, the taxpayer has a "reasonable period of time" to respond to the hearing officer's recommendation. If the taxpayer does not respond to this recommendation in some timely manner, a letter of determination and Notice of Action are issued. As a result, a taxpayer who does not submit their response within what the Board considers to be a "reasonable period of time" will not have their rebuttal heard prior to the issuance of the letter of determination and Notice of Action. The only recourse to the taxpayer at this point would be an appeal to the State Board of Equalization. This may result in a significant expense of time and money to the taxpayer. (*California Trade and Commerce Agency*, Regulation Review Unit, p. 2)

**Response:** The proposed regulations deal equally with protests filed by individuals, which may involve a single issue with minimal complexity, and multinational corporations, which may involve complex issues of income division amongst jurisdictions. As the comment notes, one size will not fit all circumstances. The length of time it takes the hearing officer to make a determination will vary from case to case and may be influenced by other workload considerations. Though not stated in the proposed regulation, it was the department's intent that the taxpayer would be advised of the time period within which to respond to the hearing officer's recommendation.

**Recommendation:** Add language to the proposed regulation setting forth guidelines for department actions and language stating that the amount of time the taxpayer will be given to respond to the hearing officer's recommendation will be stated in the letter but, in any event, shall not be less than 30 days.

**Comment:** After the protest hearing and upon receiving the hearing officer's recommendation, the taxpayer retains a representative to review the file who discovers a new issue which can resolve the case. The inability to raise a new



issue may require the case to be pursued at the appeal level with added expense. In addition, the FTB might claim a failure to exhaust administrative remedies defense. Alternatively, a factual development may change a taxpayer's view or the department's view over the proper makeup of a unitary group; here it is very common for the hearing officer to take a different view of the proper combination than the auditor, and many times this will be appropriate; both sides should be allowed to change original views in an area as fact intensive as this. (*Ernst & Young LLP*, p. 4)

**Response:** The proposed regulation provides for the hearing officer to provide the taxpayer with the hearing officer's recommendation. The taxpayer will be given a reasonable period of time to respond to the recommendation before the department makes a determination on the protest. This process obviously contemplates that the taxpayer's response to the hearing officer's recommendation may result in a change in that recommendation, or there would be no need to provide an opportunity to respond. A change in that recommendation may result due to the raising of new issues, particularly those that are related to the hearing officer's recommendation.

Nonetheless, it is also true that all processes must come to an end. A taxpayer that has not raised an issue in a timely manner in the protest process does not have an absolute right to have it considered at the protest level. The taxpayer retains the opportunity to raise the issue on appeal or in a claim for refund.

It is difficult to see how the department could make a failure-to-exhaust claim if the taxpayer has not been given the opportunity to present an issue. The department does not believe that it is necessary for an issue to be raised in a protest in order that it be made the subject matter of an appeal or a claim for refund.

**Recommendation:** No change is required.

**(i)(2)**

**Comment:** The granting of hearings should be encouraged if it does not interfere with the completion of the protest in a timely manner. (*Staff*)

**Response:** Not applicable.

**Recommendation:** Make appropriate changes.